



# Legislative Audit Division

State of Montana

Report to the Legislature

December 2004

## Financial-Compliance Audit For the Two Fiscal Years Ended June 30, 2004

### Public Employees' Retirement Board

Department of Administration  
A component unit of the state of Montana

We performed a financial-compliance audit of the Public Employees' Retirement Board for the two fiscal years ended June 30, 2004. This report contains four recommendations relating to:

- ▶ The actuarial soundness of the retirement systems
- ▶ Compliance with state laws regarding the implementation of the Public Employees' Retirement System— Defined Contribution Retirement Plan
- ▶ Lack of reconciliation controls over external investments

This report also contains the financial statements and our independent auditor's report on the Public Employees' Retirement Board for the fiscal year ended June 30, 2004. The financial audit of the Public Employees' Retirement Board's financial statements for the fiscal year ended June 30, 2003, was issued in a separate report in November 2003 (03-08).

Direct comments/inquiries to:  
Legislative Audit Division  
Room 160, State Capitol  
PO Box 201705  
Helena MT 59620-1705

04-08

Help eliminate fraud, waste, and abuse in state government. Call the Fraud Hotline at 1-800-222-4446 statewide or 444-4446 in Helena.

## FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2005, will be issued by March 31, 2006. The Single Audit Report for the two fiscal years ended June 30, 2003, was issued on March 23, 2004. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator  
Office of Budget and Program Planning  
State Capitol  
Helena MT 59620  
Phone (406) 444-3616

Legislative Audit Division  
Room 160, State Capitol  
PO Box 201705  
Helena MT 59620-1705

### MEMBERS OF THE LEGISLATIVE AUDIT COMMITTEE

Senator John Cobb  
Senator Mike Cooney  
Senator Jim Elliott, Vice Chair  
Senator John Esp  
Senator Dan Harrington  
Senator Corey Stapleton

Representative Dee Brown  
Representative Tim Callahan  
Representative Hal Jacobson  
Representative John Musgrove  
Representative Jeff Pattison, Chair  
Representative Rick Ripley

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

December 2004

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial-compliance audit report on the Public Employees' Retirement Board (PERB), a component unit of the state of Montana, for the two fiscal years ended June 30, 2004. Included in this report are recommendations related to the actuarial soundness of three retirement systems, compliance with state laws regarding the implementation of the Public Employees' Retirement System - Defined Contribution Retirement Plan (PERS-DCRP), and a lack of reconciliation controls over external investments. It also contains two disclosure issues concerning the PERS-DCRP INTERCAP loan.

We issued an unqualified opinion on PERB's financial statements for the fiscal year ended June 30, 2004, with comparative totals for June 30, 2003. Our audit opinion on the financial statements is also contained in PERB's Comprehensive Annual Financial Report. Copies of the PERB's annual report for fiscal year 2003-04 can be obtained from the Montana Public Employee Retirement Administration (MPERA). The annual report contains background, statistical, and actuarial information that is not included in this audit report which may be of interest to legislators or the public.

The written response to the audit recommendations is included at the end of the audit report. We thank the executive director and his staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

*(Signature on File)*

Scott A. Seacat  
Legislative Auditor

# **Legislative Audit Division**

---

**Financial-Compliance Audit**

**For the Two Fiscal Years Ended June 30, 2004**

## **Public Employees' Retirement Board**

**Department of Administration**

**A component unit of the state of Montana**

Members of the audit staff involved in this audit were Pearl M. Allen,  
Jeane Carstensen-Garrett, Melissa Heinert, and Laura L. Norris.

## Table of Contents

---

Appointed and Administrative Officials.....	iii
Report Summary .....	S-1
<b>Introduction.....</b>	<b>1</b>
Introduction.....	1
Background.....	1
Defined Benefit Pension Trust Funds.....	2
Defined Contribution Pension Trust Funds .....	2
Prior Audit Recommendations.....	3
<b>Findings and Recommendations.....</b>	<b>5</b>
Three Retirement Systems Actuarially Unsound.....	5
Public Employees' Retirement System-Defined Contribution Retirement Plan (PERS-DCRP) .....	7
Diversion of Pension Trust Fund Assets Through An Inter-Entity Loan .....	7
Laws Governing PERS-DCRP Contribution Transfers and Allocations.....	8
Disability and Education Contribution Transfers.....	9
Employer Contribution Transfers.....	10
Summary .....	11
Investment Reconciliation Controls.....	11
<b>Disclosure Issues.....</b>	<b>15</b>
PERS-DCRP Long-Term Loan May Violate Constitutional Requirements .....	15
INTERCAP Loan Restructured .....	16
<b>Independent Auditor's Report &amp; Board Financial Statements, Required Supplementary Information, and Supplementary Information .....</b>	<b>A-1</b>
Independent Auditor's Report .....	A-3
<b>The Public Employees' Retirement Board's Management's Discussion and Analysis, Financial Statements, Required Supplementary Information, and Supplementary Information</b>	
Management's Discussion & Analysis .....	A-6
Statement of Fiduciary Net Assets - Pension Trust Funds as of June 30, 2004 - with comparative totals for June 30, 2003 .....	A-18
Statement of Changes in Fiduciary Net Assets - Pension Trust Funds for the Fiscal Year Ended June 30, 2004 - with comparative totals for June 30, 2003 .....	A-20
Notes to the Financial Statements for the Fiscal Years Ended June 30, 2004 and 2003 .....	A-22
Schedule of Funding Progress .....	A-60

## Table of Contents

---

Schedule of Employer Contributions & Other Contributing Entities.....	A-62
Notes to the Required Supplementary Information .....	A-64
Schedule of Administrative Expenses Year Ended June 30, 2004 .....	A-67
Schedule of Investment Expenses Year Ended June 30, 2004 .....	A-68
Schedule of Consultants Year Ended June 30, 2004 .....	A-69
Detail of Fiduciary Net Assets (PERS-DBRP and PERS-DBEd) As of June 30, 2004 .....	A-70
Detail of Changes in Fiduciary Net Assets (PERS-DBRP and PERS-DBEd) for the Fiscal Year Ended June 30, 2004.....	A-71
Detail of Fiduciary Net Assets (PERS-DCRP, PERS-DCEd and PERS-DC Disability) as of June 30, 2004 .....	A-72
Detail of Changes in Fiduciary Net Assets (PERS-DCRP, PERS-DCEd and PERS-DC Disability) For the Fiscal Year Ended June 30, 2004 .....	A-72
Board's Response .....	B-1
Public Employees' Retirement Board.....	B-3

## Appointed and Administrative Officials

---

### Public Employees' Retirement Board

		Term <u>Expires</u>
Terry Teichrow, President	Helena	3/31/05
Carole Carey, Vice President	Ekalaka	3/31/07
Betty Lou Kasten	Brockway	3/31/06
Robert Griffith	Helena	3/31/08
N. Jay Klawon	Hamilton	3/31/09
Troy McGee	Helena	3/31/08
Jim Pierce	Livingston	3/31/09

### Administrative Officials

Mike O'Connor, Executive Director

Kim Flatow, Member Services Bureau Chief

Roxanne Minnehan, Fiscal Services Bureau Chief

Kathy Samson, Defined Contribution Plans & Educational Services  
Bureau Chief

For additional information concerning the Montana Public  
Employees' Retirement Board, contact Mike O'Connor, Executive  
Director, at:

100 North Park Avenue Suite 220  
PO Box 200131  
Helena MT 59620-0131  
(406) 444-3154

e-mail: [moconnor@state.mt.us](mailto:moconnor@state.mt.us)

**Public Employees'  
Retirement Board**

This report contains the results of our financial-compliance audit of the Public Employees' Retirement Board (PERB) for the two fiscal years ended June 30, 2004. We issued an unqualified opinion on the financial statements for the fiscal year ended June 30, 2004. This means the reader can rely on the financial information presented. The financial audit of the PERB's financial statements for the fiscal year ended June 30, 2003 was issued in a separate report in November 2003 (03-08).

Montana Public Employee Retirement Administration (MPERA) personnel prepare PERB financial statements from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) with adjustment. Adjustments are made to properly present financial activity.

This report contains recommendations related to the actuarial soundness of three retirement systems, compliance with state laws regarding the implementation of the Public Employees' Retirement System - Defined Contribution Retirement Plan (PERS-DCRP), and a lack of reconciliation controls over external investments. It also contains two disclosure issues concerning the PERS-DCRP INTERCAP loan. The previous financial-compliance audit report for the two fiscal years ended June 30, 2002, contained two recommendations to the PERB, which were implemented.

The listing below serves as a means of summarizing the recommendations contained in the report, the PERB response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the PERB seek legislation for funding changes to ensure the PERS-DBRP, SRS, and GWPORS are funded on an actuarially sound basis, as required by PERB policy and the Montana Constitution. .... 7

Board Response: Concur. See page B-3.



## Report Summary

---

### Recommendation #2

We recommend the PERB comply with the constitutional requirement prohibiting diversion of public retirement system assets. 8

Board Response: Concur. See page B-4.

### Recommendation #3

We recommend the PERB:

- A. Seek legislation, or an Attorney General's opinion, to clarify the appropriate interpretation of state laws governing PERS-DCRP transfer calculations.
- B. Match education fund expenses with education fund contributions to eliminate diversion of pension trust fund assets. 11

Board Response: Concur. See page B-5.

### Recommendation #4

We recommend the PERB implement procedures to ensure mutual and fixed fund asset balances recorded on SABHRS reconcile to external investment reports. .... 13

Board Response: Concur. See page B-7.

# Introduction

---

---

## Introduction

We performed a financial-compliance audit of the Public Employees' Retirement Board (PERB) for the two fiscal years ended June 30, 2004. The objectives of our audit were to:

1. Determine PERB's compliance with applicable laws and regulations.
2. Recommend improvements in PERB's management and internal controls.
3. Determine the status of prior audit recommendations.
4. Determine if the financial statements prepared by the Montana Public Employee Retirement Administration (MPERA) fairly present PERB's fiduciary net assets as of June 30, 2004, and the changes in fiduciary net assets for the fiscal year then ended, in conformity with generally accepted accounting principles.

The financial audit of the PERB's financial statements for the fiscal year ended June 30, 2003, was issued in a separate report in November 2003 (03-08).

MPERA prepares PERB's financial statements from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) with adjustment. Adjustments are made to accurately present financial activity to the readers of the statements.

This report contains four recommendations. Other areas of concern deemed not to have a significant effect on the successful operation of PERB are not specifically included in the report, but have been discussed with management. In accordance with section 5-13-307, MCA, we analyzed the cost of implementing the recommendations contained in this report and determined it was not significant.

---

## Background

The PERB is a component unit of the state of Montana. A component unit is a legally separate organization for which the state of Montana is financially accountable. The PERB has exclusive control of the funds of seven retirement systems, the Volunteer

## Introduction

---

Firefighters' Compensation Act, as well as the Section 457 Deferred Compensation Plan. The PERB governs MPERA, which is responsible for daily administration of the retirement systems. The governor appoints the seven board members to five-year terms.

---

### Defined Benefit Pension Trust Funds

PERB manages the activities of the following defined benefit pension trust funds:

- ▶ Public Employees' Retirement System-Defined Benefit Retirement Plan (PERS-DBRP)
- ▶ Judges' Retirement System (JRS)
- ▶ Highway Patrol Officers' Retirement System (HPORS)
- ▶ Sheriffs' Retirement System (SRS)
- ▶ Game Wardens' and Peace Officers' Retirement System (GWORS)
- ▶ Municipal Police Officers' Retirement System (MPORS)
- ▶ Firefighters' Unified Retirement System (FURS)
- ▶ Volunteer Firefighters' Compensation Act (VFCA)

These funds provide pension, disability, and death benefits to eligible members. The monthly benefits are based on years of service and salary levels while still employed. The Volunteer Firefighters' Compensation Act provides pension, disability, and death benefits to volunteer firefighters who are members of eligible Montana volunteer fire companies. Monthly benefits are based on years of service.

---

### Defined Contribution Pension Trust Funds

PERB manages the activities of the following defined contribution pension trust funds:

- ▶ Public Employees' Retirement System - Defined Contribution Retirement Plan (PERS-DCRP)
- ▶ Section 457 Deferred Compensation Plan (457 Plan)

The 457 Plan allows employees to set aside a portion of their salary each payday toward retirement while deferring state and federal income taxes until future years. The PERS-DCRP takes the PERS contributions attributable to the employee and allows the employee to invest the contributions at his or her discretion. Employees participating in these two plans have two investment options:

- ▶ the fixed option, which guarantees both principal (contributions) and a pre-established quarterly rate of earnings;
- ▶ the variable option, which consists of numerous mutual funds.

Participating employees are allowed to invest in both the fixed and variable options. Those participating in the variable option may invest in as many offered funds as desired.

Withdrawal of deferred compensation funds is only available to employees upon separation from service, retirement, death, or upon an unforeseeable emergency meeting IRS-specified criteria while still employed. Withdrawals from PERS-DCRP are available upon termination of a PERS covered position.

---

### **Prior Audit Recommendations**

The financial-compliance audit report for the two fiscal years ended June 30, 2002, contained two recommendations to the PERB. The recommendations addressed reassessing the actuarial assumptions of the Game Warden's and Peace Officers' Retirement System and recording licenses and registration fees on the state's accounting system. During our financial audit for the fiscal year ended June 30, 2003, we determined the PERB implemented both recommendations.



# Findings and Recommendations

---

---

## Three Retirement Systems Actuarially Unsound

Based on the July 1, 2004, actuarial valuations, the Public Employees' Retirement System - Defined Benefit Retirement Plan (PERS - DBRP), Sheriffs' Retirement System (SRS), and Game Wardens' and Peace Officers' Retirement System (GWPORS) are not actuarially sound, contrary to the Montana Constitution and state law.

Article VIII, Section 15, of the Montana Constitution requires public retirement systems be funded on an actuarially sound basis. State law defines a defined benefit retirement system as actuarially sound when its contributions are sufficient to pay the full actuarial cost of the plan over a period of up to 30 years.

The PERB obtains an actuarial valuation of each of its eight defined benefit retirement plans biennially. The most recent actuarial valuation was as of July 1, 2004. The PERB actuary determined the employer contribution rate would have to be increased as follows, starting July 1, 2005, to maintain an amortization of the UAAL over the 30-year period starting July 1, 2004:

PERS - DBRP	1.19%; from 6.9% to 8.09%;
SRS	2.15%; from 9.535% to 11.685%; and
GWPORS	.23%; from 9.00% to 9.23%.

The UAAL for each system has grown at an increasing rate, as shown in Table 1.

## Findings and Recommendations

---

**Table 1**  
**Unfunded Actuarial Accrued Liability\***

<u>Valuation Date</u>	<u>PERS-DBRP</u>	<u>SRS</u>	<u>GWPORS</u>
7/1/2000 <sup>a</sup>	(\$569,940,000)	(\$38,502,000)	(\$9,044,000)
7/1/2000 <sup>b</sup>	(251,540,000)	(26,002,000)	(5,544,000)
7/1/2002 <sup>b</sup>	983,000	(16,965,000)	379,000
7/1/2004 <sup>b</sup>	466,798,000	7,586,000	5,100,000

\* The negative amounts indicate the systems did not have an unfunded actuarial accrued liability.

<sup>a</sup> Does not include the effects of legislation passed in the 2001 Legislative session.

<sup>b</sup> Includes the effects of legislation passed in the 2001 Legislative session.

**Source: Compiled by the Legislative Audit Division from actuarial reports.**

In the July 1, 2004, valuation, the PERB actuary determined the UAAL for these three systems does not amortize without an increase in contributions. In the July 1, 2002, valuation, the PERB actuary determined the amortization period was .1 year for PERS-DBRP and approximately 30 years for each SRS and GWPORS. The actuary attributed the growth in the unfunded liability of the systems primarily to actuarial investment returns below the actuarial investment return assumption of eight percent for all three systems.

The PERB Funding and Benefits Policy states, "Whenever, through the use of long-term cash flow projections, the amortization period of a system's unfunded liabilities is projected to exceed 30 years for two consecutive valuations and the Board cannot reasonably anticipate that the amortization period would decline without an increase in funding sources, it is the obligation of PERB to recommend to the legislature that funding be increased."

## Findings and Recommendations

---

Because the July 1, 2004, actuarial valuation projected an amortization period of the unfunded liabilities that exceeds 30 years for the PERS-DBRP, SRS, and GWPORS, the PERB should seek legislation for funding changes, as required by board policy. PERB plans to submit legislation to the 2005 legislature changing contribution rates to make the retirement systems actuarially sound.

### **Recommendation #1**

**We recommend the PERB seek legislation for funding changes to ensure the PERS-DBRP, SRS, and GWPORS are funded on an actuarially sound basis, as required by PERB policy and the Montana Constitution.**

---

### **Public Employees' Retirement System- Defined Contribution Retirement Plan (PERS- DCRP)**

The PERS-DCRP became effective on July 1, 2002. PERB has had to interpret and implement over 20 new statutes to ensure the PERS-DCRP was operated in accordance with state law. The following report sections identify areas where PERB can enhance compliance with state law concerning the implementation and operation of the PERS-DCRP.

---

### **Diversion of Pension Trust Fund Assets Through An Inter-Entity Loan**

**The PERB diverted funds from the PERS-DBRP Trust by borrowing funds from the PERS-DBRP Education Fund.**

Article VIII, Section 15, of the Montana Constitution states, "Public retirement system assets, including income and actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated and shall be held in trust to provide benefits to participants and their beneficiaries and to defray administrative expenses."

On August 15, 2003, an installment on the PERS-DCRP startup INTERCAP loan came due. The PERS-DCRP Administrative Fund did not have enough cash flow at that time to make the payment, so the fund obtained an inter-entity loan of \$114,000 from the PERS-DBRP Education Fund to make the INTERCAP loan payment. The



## Findings and Recommendations

---

Department of Administration approved the loan, with a rate of return at the Short Term Investment Pool rate.

MPERA personnel stated they believe the money held within the PERS is constitutionally permitted to be used for providing benefits or defraying administrative expenses between plans within the PERS. Because MPERA personnel believe the DBRP Education Fund is not restricted within PERS, and the DCRP Administrative Fund is used for administrative expenses within PERS, they believe the loan is not inappropriate.

Although both the PERS-DBRP and the PERS-DCRP are under the same system, the membership in each plan is separate and distinct. We believe the Constitution requires the assets of each plan to be held in trust for the members of each plan and their beneficiaries and for no other purposes. This constitutional requirement and section 19-3-2102, MCA, restrict the PERS-DBRP and PERS-DCRP assets to uses for the exclusive benefit of members of each plan. As such, we believe the PERS-DBRP Education Fund is restricted to use on behalf of PERS-DBRP members, so the loan was a diversion of public retirement system assets, which is not appropriate or legal.

### **Recommendation #2**

**We recommend the PERB comply with the constitutional requirement prohibiting diversion of public retirement system assets.**

---

### **Laws Governing PERS- DCRP Contribution Transfers and Allocations**

**Two state laws governing transfer and allocation of contributions to the PERS-DCRP can be interpreted in different ways with different results.**

According to state law, PERS members have twelve months to elect participation in the PERS-DBRP, the PERS-DCRP, or the Optional Retirement Plan (ORP). During the election period all of the participants are placed in the PERS-DBRP, and disability, education, and employer contributions are credited to the PERS-DBRP. Two

## Findings and Recommendations

---

### Disability and Education Contribution Transfers

state laws, sections 19-3-2114 and 19-3-2117, MCA, address how to transfer and allocate these contributions once an election is made, but these laws can and have been, interpreted in different ways.

When initially testing compliance with these laws, MPERA management told us once a member elects the PERS-DCRP, the member contributions are transferred to the PERS-DCRP and from that point on disability and education contributions are allocated to the PERS-DCRP. Upon further investigation, we found PERB's computer system is designed to transfer all the disability and education contributions allocated to the PERS-DBRP from the date of hire or the effective date of the PERS-DCRP (whichever is later) to the PERS-DCRP, contrary to management's understanding of MPERA procedures. Subsequently, MPERA management changed its interpretation of the law and told us the computer system was appropriately designed based on their new interpretation of the law.

Until PERS members elect the PERS-DBRP or PERS-DCRP, they are members of the PERS-DBRP. Their education contributions are allocated to the PERS-DBRP and their education expenses are paid from the PERS-DBRP. Once a member elects the PERS-DCRP, all of the education contributions, but none of the expenses, are transferred to the PERS-DCRP.

If the law is interpreted to require contributions be transferred from the election date, as MPERA management originally told us, MPERA must return \$83,154 of disability and education contributions for the period prior to the election date back to the PERS-DBRP. If the law is interpreted to require contributions be transferred from the date of hire or effective date of the plan, as the MPERA computer system is programmed to do, the related education expenses must also be transferred. By not matching expenses with related contributions, MPERA diverts assets between plans.

## Findings and Recommendations

---

### Employer Contribution Transfers

Section 19-3-2114(1)(a), MCA, states: "For an employee who was a system member on the day before the effective date of the defined contribution plan and who elects to transfer to the plan, the board shall transfer from the defined benefit plan to the member's retirement account the employee's contributions and the percentage of the employer's contributions specified in subsection (1)(b), plus 8% compounded annual interest on the total of the transferred employee and employer contributions." Section 19-3-2114(2), MCA, states: "For an employee hired on or after the effective date of the defined contribution plan who elects to become a member of the plan, the board shall transfer from the defined benefit plan to the member's retirement account an amount equal to the amount that would have been credited to the member's account pursuant to 19-3-2117 had the employee become a plan member on the employee's hire date, plus 8% compounded annual interest."

We interpreted these laws to require a member's entire transfer be calculated based on the PERS membership date. PERB applied the laws based on the contribution, rather than membership, date. PERB transferred employer contributions received prior to the July 1, 2002, effective date of the PERS-DCRP in accordance with the percentages noted in section 19-3-2114(1), MCA. PERB transferred all employer contributions received after July 1, 2002, as if the employee was enrolled in the PERS-DCRP on the plan's effective date or the employee's hire date, whichever was later. MPERA management told us they applied the laws based on the contribution date to provide constitutionally required equal protection for all members.

We looked at the accounts of ten employees who were members of the PERS prior to July 1, 2002, who elected to switch plans prior to June 30, 2003. We noted calculation differences between the two methodologies of as much as \$124 in each of the ten individual retirement accounts for employer contributions. Since the amount of interest transferred to a member's account is based on the employee and employer contributions transferred, an error in the employer contribution transfer calculation would result in an error in the calculation of the interest transfer.

## Findings and Recommendations

---

This may have affected 1,412 active participants who were members of PERS as of June 30, 2002, and selected the PERS-DCRP or ORP by June 30, 2003. The current transfer procedure could also affect any members who were inactive as of June 30, 2002, become active prior to retirement, and select the PERS-DCRP.

### Summary

MPERA should seek legislation, or an Attorney General's opinion, to clarify the appropriate interpretation of state laws concerning disability, education, and employer contribution transfers.

#### **Recommendation #3**

**We recommend the PERB:**

- A. Seek legislation, or an Attorney General's opinion, to clarify the appropriate interpretation of state laws governing PERS-DCRP transfer calculations.**
- B. Match education fund expenses with education fund contributions to eliminate diversion of pension trust fund assets.**

---

### Investment Reconciliation Controls

**PERB does not have controls to identify reasons for differences between the PERS-DCRP and 457 Plan investments recorded on the state's accounting records and external investment reports.**

PERB contracts with external investment managers and plan administrators to invest the PERS-DCRP and 457 Plan participant contributions. These external parties send quarterly reports to MPERA identifying the quarterly activity related to contributions, investment earnings, investment fees, and withdrawals. Along with the quarterly activity, the reports provide balances for the investments.

On October 29, 2004, we requested from MPERA personnel a reconciliation between the investment balances recorded on SABHRS and the balances on the external investment reports. A reconciliation had not been done at that time. As of December 7,

## Findings and Recommendations

---

2004, unreconciled differences relating to the June 30, 2004, investment balances in the PERS-DCRP and 457 Plan, are shown below in Table 2.

<b>Table 2</b>				
<b><u>Unreconciled Investment Amounts</u></b>				
<u>Pension Trust</u> <u>Fund</u>	<u>Investment</u> <u>Type</u>	<u>Per SABHRS</u>	<u>Per</u> <u>Investment</u> <u>Manager</u>	<u>Unreconciled</u> <u>Difference</u>
457 Plan	Fixed	\$145,120,645	\$147,169,982	(\$ 2,049,337)
457 Plan	Mutual	79,244,018	79,542,386	( 298,368)
PERS-DCRP	Mutual	19,566,399	19,564,103	2,296
PERS-DCRP	Fixed	914,702	937,857	(23,155)

**Source: Compiled by the Legislative Audit Division from PERB records**

An effective control system includes a timely reconciliation of the investment balances on the accounting system to the external investment reports. PERB currently does not have a reconciliation procedure in place to ensure that the 457 Plan and PERS-DCRP investment balances recorded on SABHRS reconcile to the external investment reports. As of December 7, 2004, MPERA personnel could not explain the unreconciled differences noted in the table above. MPERA has a fiduciary responsibility to reconcile the investment balances.

MPERA personnel stated that they thought reconciling contributions and taking the investing, distribution, and fee activity from the quarterly reports would be sufficient to ensure investment amounts recorded on SABHRS were correct. MPERA plans to implement procedures to ensure that the investment amounts recorded on SABHRS reconcile to the external investment reports.

## Findings and Recommendations

---

### Recommendation #1

We recommend the PERB implement procedures to ensure mutual and fixed fund asset balances recorded on SABHRS reconcile to external investment reports.



# Disclosure Issues

---

---

## **PERS-DCRP Long-Term Loan May Violate Constitutional Requirements**

**The 1999 legislature authorized state debt without the constitutionally mandated two-thirds vote, to implement the PERS-DCRP.**

Chapter 471, Laws of 1999, authorized the PERB to obtain a loan from the INTERCAP Revolving Loan Program to pay startup costs of the PERS-DCRP. The Department of Administration entered into a 10-year loan agreement with the Board of Investments on June 16, 2000 for this purpose. As of June 30, 2004, the PERB owed a balance of \$1,400,195 on the loan. PERS-DCRP revenues, consisting of employer and employee contributions and investment earnings, are irrevocably pledged for the repayment of the loan. The PERS-DCRP revenues are considered state revenues. Because state revenues are pledged for repayment, we believe the use of the INTERCAP Revolving Loan Program to fund the startup costs constitutes state debt.

Article VIII, Section 8, of the Montana Constitution prohibits the creation of state debt unless authorized by a two-thirds vote of each house of the legislature. Chapter 471, Laws of 1999, did not receive a two-thirds vote in the House of Representatives. As such, we believe the establishment of this loan violates the constitution.

In our 2000 audit, we recommended the PERB seek legislative direction in order to resolve these concerns. The PERB did not seek legislative direction because MPERA personnel did not believe the loan constituted state debt, so did not agree corrective action was necessary. In our 2002 audit, we said "PERB should take appropriate measures to resolve this issue, which may include obtaining an Attorney General's opinion on whether the loan represents state debt or seeking legislative authorization of the loan as required by the Constitution." PERB has not yet acted to resolve this issue, but MPERA management told us PERB plans to seek legislation to have the state pay off the INTERCAP loan.



## Disclosure Issues

---

---

### INTERCAP Loan Restructured

**The PERB has restructured the length and the payments of its INTERCAP loan to match its anticipated administrative revenue stream.**

On a quarterly basis the PERS-DCRP charges each of its participants an administrative fee on the balance in the participant's retirement account. The administrative fee is collected to pay for all of the administrative costs of the plan. The repayment of the INTERCAP loan is classified as an administrative cost and is to be paid off with the administrative fee.

When the PERS-DCRP became effective, PERB believed that they would have a transfer of approximately 20 percent of the existing PERS-DBRP participants. In actuality about four percent of PERS-DBRP participants transferred to the PERS-DCRP, and the majority of the participants moved to the PERS-DCRP in the last month of the election period. Since the PERS-DCRP did not have investment balances throughout the entire year, the PERS-DCRP did not collect adequate revenue to make the loan payment. Therefore, PERB requested and received an inter-entity loan from the PERS-DBRP Education Fund and loaned it to the PERS-DCRP Administration Fund.

Management stated that with fewer participants in the plan, the PERB did not have an adequate fee set to cover the scheduled debt service payments and its current administrative costs for the PERS-DCRP. MPERA management also stated that, as the member balances grow, the PERS-DCRP will receive more money and this will enable the repayment of the loan. Member balances grow through additional contributions and through investment earnings. Also, as the plan is in existence longer, more participants are expected to join the plan and provide a larger base to pay off the start up costs of the plan.

Based on the above analyses, PERB restructured the loan by extending it out five more years and reducing the first few years' principal payments. Debt service payments under the original loan totaled \$1,669,556, compared to the new debt service payments

totaling \$1,953,850, an increase of \$284,284. The original amount borrowed was \$1,498,000. Interest on this principal more than doubled with restructuring, increasing from \$171,556 under the original loan agreement to \$455,850 under the restructured agreement. Restructuring the loan rather than charging a higher administrative rate to the PERS-DCRP participants increases the administrative costs plan participants will ultimately have to pay.

**Independent Auditor's Report & Board  
Financial Statements, Required Supplementary  
Information, and Supplementary Information**

---



# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Fiduciary Net Assets - Pension Trust Funds of the Public Employees' Retirement Board, a component unit of the state of Montana, as of June 30, 2004 - with comparative totals for June 30, 2003, and the related Statement of Changes in Fiduciary Net Assets - Pension Trust Funds for the year ended June 30, 2004 - with comparative totals for June 30, 2003. These financial statements are the responsibility of the Public Employees' Retirement Board. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Public Employees' Retirement Board's financial statements for the fiscal year ended June 30, 2003, and, in our report dated November 6, 2003, we expressed an unqualified opinion on the respective financial statements of the fiduciary fund activities.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Public Employees' Retirement Board as of June 30, 2004, and the changes in fiduciary net assets for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis, the Schedule of Funding Progress, and the Schedule of Employer Contributions & Other Contributing Entities are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the Public Employees' Retirement Board. The Schedules of Administrative Expenses, Investment Expenses, and Consultants; the Detail of Fiduciary Net Assets (PERS-DBRP and PERS-DBEd) and the Detail of Fiduciary Net Assets (PERS-DCRP, PERS-DCEd and PERS-DC Disability) as of June 30, 2004; and the related Detail of Changes in Fiduciary Net Assets (PERS-DBRP and PERS-DBEd) and the Detail of Changes in Fiduciary Net Assets (PERS-DCRP, PERS-DCEd and PERS-DC Disability) for the fiscal year then ended are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

The financial statements include summarized prior-year comparative information. Such information does not include all of the information required to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Public Employees' Retirement Board's financial statements for the year ended June 30, 2003, from which such summarized information was derived.

Respectfully submitted,

*(Signature on File)*

James Gillett, CPA  
Deputy Legislative Auditor

November 15, 2004

**The Public Employees' Retirement Board's  
Management's Discussion and Analysis,  
Financial Statements, Required Supplementary  
Information, and Supplementary Information**

---

---

This page intentionally left blank



---

# Public Employees' Retirement Board

## A Component Unit of the State of Montana

### Management's Discussion and Analysis

*This section presents management's discussion and analysis of the Montana Public Employees' Retirement Board's financial presentation and performance of the plans administered by the Board for the year ending June 30, 2004.*

#### Financial Highlights

- ♦ The Montana Public Employees' Retirement Board's combined total net assets of the defined benefit plans increased by \$409 million or 12.6 percent in fiscal year 2004. The increase was primarily due to the investment income in each of the retirement plans.
- ♦ The Montana Public Employees' Retirement Board's defined contribution plans combined total net assets increased by \$20.8 million or 9.3 percent in fiscal year 2004. The total increase in Net Assets was due to the PERS-Defined Contribution Retirement Plan (DCRP) opening in fiscal year 2003 and an increase in investment income in both the DCRP and the 457 plan.
- ♦ Revenues (additions to plan net assets) for the Board's defined benefit plans for fiscal year 2004 was \$595 million, which includes member and employer contributions of \$163 million, net investment income of \$431 million and prior period adjustments of \$1.2 million.
- ♦ Revenues (additions to plan net assets) for the Board's defined contribution plans for fiscal year 2004 was \$38.9 million, which includes member and employer contributions of \$19.6 million, net investment income of \$18.5 million and prior period adjustments of \$741 thousand.
- ♦ Expenses (deductions to plan net assets) for the Board's defined benefit plans decreased from \$192 million in fiscal year 2003 to \$186 million in fiscal year 2004 or about 3.1% decrease. The decrease in 2004 is primarily due to the one time expense in 2003 of existing members' contributions transferring to the DCRP and the Optional Retirement Plan (ORP).
- ♦ Expenses (deductions to plan net assets) for the Board's defined contribution plans increased from \$12.8 million in fiscal year 2003 to \$18 million in fiscal year 2004 or about 40.8%. The increase in expenses is primarily due to the increase in participant refunds/distributions.
- ♦ The Montana Public Employees' Retirement Board's defined benefit plans funding objective is to meet long-term benefit obligations. As of July 1, 2004, the date of the latest actuarial valuation, three of the defined benefit plans were not able to pay off the unfunded liabilities over 30 years or less. As a whole the plans were actuarially funded at an average of 83.4 percent. It is important to understand this measure reflects the actuarial value of the defined benefit plans' net assets, which exceeds the actual fair value published in the financial statements. Investment earnings are critical

---

*to the defined benefit plans and the market decline and associated investment losses in fiscal years 2001 and 2002 have had major impacts on the plans due to the smoothing of market value gains and losses over four years.*

## **Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to the Public Employees' Retirement Board's (PERB) financial reporting which is comprised of the following components:

- (1) Financial Statements
- (2) Notes to the Financial Statements
- (3) Required Supplementary Information

Collectively, this information presents the combined net assets held in trust for pension benefits for each of the plans administered by the Public Employees' Retirement Board as of June 30, 2004. This financial information also summarizes the combined changes in net assets held in trust for pension benefits for the year then ended. The information in each of these components is briefly summarized as follows:

- (1) Financial Statements. For the fiscal year ended June 30, 2004, financial statements are presented for the fiduciary funds administered by the PERB. Fiduciary funds are used to account for resources held for the benefit of parties outside of the PERB. The fiduciary funds are held for participants in eight defined benefit plans and two defined contribution plans.
  - The Statement of Fiduciary Net Assets is presented for the pension trust funds at June 30, 2004. These financial state-

ments reflect the resources available to pay benefits to retirees and beneficiaries, at the end of the year reported.

- The Statement of Changes in Fiduciary Net Assets is presented for the pension trust funds for the year ended June 30, 2004. These financial statements reflect the changes in the resources available to pay benefits to retirees and beneficiaries, at the end of the year reported.
- (2) Notes to the Financial Statements. The Notes to the Financial Statements provide additional information that is essential for a full understanding of the data provided in the financial statements. Information in the Notes to the Financial Statements is described as follows:
    - Note A provides a summary of significant accounting policies, including the basis of accounting, capital assets and equipment used in operations, operating lease, derivatives, methods used to value investments, summaries of investment vendors and other significant accounting policies or explanations.
    - Note B provides information about litigation.
    - Note C describes the debt obligation of the PERS-DCRP. The INTERCAP implementation loan for the PERS-DCRP is to be paid back over fifteen years. The inter-entity loan from the DB Education Fund was used to help pay the DCRP administrative expenses due to the cash position of the DCRP.
    - Note D describes the plans' membership and descriptions of the plans administered by the Public Employees' Retirement Board. Summaries of

benefits and contribution information are also provided.

- (3) Required Supplementary Information. The required supplementary information consists of the schedules of funding status and required contributions and related notes concerning actuarial information of the defined benefit pension plans administered by the PERB.

### Investments

The Montana Board of Investments (BOI), as authorized by state law, invests the defined benefit plans' assets in investment pools. Each plan owns an equity position in the pools and receives proportionate investment income from the pool in accordance with respective ownership. The investment pools are: Montana Domestic Equity Pool, Retirement Fund Bond Pool, Montana International Pool, Montana Short Term Investment Pool and Montana Private Equity Pool. Each

## Financial Analysis of the Systems - Defined Benefit Plans

### Fiduciary Net Assets - Defined Benefit Plans

**As of June 30, 2004** - and comparative totals for June 30, 2003

(dollars in thousands)

	PERS		JRS		HPORS		SRS	
	2004	2003	2004	2003	2004	2003	2004	2003
<b>Assets:</b>								
Cash and Receivables	116,329	96,310	1,894	1,051	2,747	1,961	5,713	4,183
Securities Lending Collateral	141,311	90,289	2,237	1,436	3,952	2,570	6,997	4,462
Investments	2,914,680	2,608,986	43,062	38,745	75,881	69,185	134,855	119,854
Property and Equipment	1	2						
Intangible Assets	535		6		6		6	
<b>Total Assets</b>	<b>3,172,856</b>	<b>2,795,587</b>	<b>47,199</b>	<b>41,232</b>	<b>82,586</b>	<b>73,716</b>	<b>147,571</b>	<b>128,499</b>
<b>Liabilities:</b>								
Securities Lending Collateral	141,311	90,289	2,237	1,437	3,952	2,570	6,997	4,462
Other Payables	866	8,936	7	3	25	15	70	42
<b>Total Liabilities</b>	<b>142,177</b>	<b>99,225</b>	<b>2,244</b>	<b>1,440</b>	<b>3,977</b>	<b>2,585</b>	<b>7,067</b>	<b>4,504</b>
<b>Total Net Assets</b>	<b>3,030,679</b>	<b>2,696,362</b>	<b>44,955</b>	<b>39,792</b>	<b>78,609</b>	<b>71,131</b>	<b>140,504</b>	<b>123,995</b>

### Changes In Fiduciary Net Assets - Defined Benefit Plans

**For the year ended June 30, 2004** - and comparative totals for June 30, 2003

(dollars in thousands)

	PERS		JRS		HPORS		SRS	
	2004	2003	2004	2003	2004	2003	2004	2003
<b>Additions:</b>								
Contributions	121,298	120,615	1,579	1,338	3,950	4,025	5,369	5,177
Investment Income (Loss)	360,266	167,331	5,248	2,661	9,322	4,611	16,404	8,164
Prior Period Adjustments	1,056		20		26		12	
<b>Total Additions</b>	<b>482,620</b>	<b>287,946</b>	<b>6,847</b>	<b>3,999</b>	<b>13,298</b>	<b>8,636</b>	<b>21,785</b>	<b>13,341</b>
<b>Deductions:</b>								
Benefits	132,683	122,204	1,670	1,552	5,493	5,160	4,903	4,307
Refunds/Distributions	11,311	10,446			296	108	318	475
Administrative Expenses	2,825	2,254	14	3	31	15	55	32
Miscellaneous Expenses	1,484	21,948						
<b>Total Deductions</b>	<b>148,303</b>	<b>156,852</b>	<b>1,684</b>	<b>1,555</b>	<b>5,820</b>	<b>5,283</b>	<b>5,276</b>	<b>4,814</b>
<b>Incr/(Decr) in Net Assets</b>	<b>334,316</b>	<b>131,094</b>	<b>5,163</b>	<b>2,444</b>	<b>7,478</b>	<b>3,353</b>	<b>16,509</b>	<b>8,527</b>

plan's allocated share of the investment in the pools is shown in the Statement of Fiduciary Net Assets of the plan. Investment gains and losses are reported in the Statement of Changes in Fiduciary Net Assets.

### Defined Benefit Plans Total Investments

At June 30, 2004, the PERB's defined benefit plans held total investments of \$3.5 billion, an increase of \$373 million from fiscal year 2003 investment totals. Below are the schedules of Net Assets and Changes in Net Assets

for the defined benefit plans.

### Analysis of Individual Systems

#### PERS - DBRP and Education

The PERS-DBRP provides retirement, disability, and death benefits for covered employees of the State, local governments and certain employees of the university systems and school districts. Member and employer contributions and earnings on investments fund the benefits of the plan. The PERS-DBRP and the Education Fund have been combined in these comparisons. The PERS-

GWPORS		MPORS		FURS		VFCA		TOTAL		Total % Change
2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	
2,695	2,030	11,155	9,232	10,467	8,552	1,705	1,484	152,705	124,803	22.4%
2,209	1,314	7,143	4,579	6,801	4,346	963	606	171,613	109,602	56.6%
42,584	35,451	137,323	121,111	130,726	115,176	18,433	16,446	3,497,544	3,124,954	11.9%
								1	2	-50.0%
6		6		6				571		100.0%
47,494	38,795	155,627	134,922	148,000	128,074	21,101	18,536	3,822,434	3,359,361	13.8%
2,209	1,314	7,143	4,579	6,801	4,346	963	606	171,613	109,603	56.6%
39	53	73	117	53	31	43	30	1,176	9,227	-87.3%
2,248	1,367	7,216	4,696	6,854	4,377	1,006	636	172,789	118,830	45.4%
45,246	37,428	148,411	130,226	141,146	123,697	20,095	17,900	3,649,645	3,240,531	12.6%

GWPORS		MPORS		FURS		VFCA		TOTAL		Total % Change
2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	
4,735	4,128	13,133	12,554	11,542	10,949	1,434	1,310	163,040	160,096	1.8%
5,073	2,541	16,392	8,530	15,692	8,066	2,271	1,259	430,668	203,163	112.0%
15		4		22		21		1,176		100.0%
9,823	6,669	29,529	21,084	27,256	19,015	3,726	2,569	594,884	363,259	63.8%
1,460	1,316	10,885	10,426	9,674	9,081	1,479	1,412	168,247	155,458	8.2%
504	355	388	373	79	83			12,896	11,840	8.9%
42	25	70	40	53	30	40	30	3,130	2,429	28.9%
						12	12	1,496	21,960	-93.2%
2,006	1,696	11,343	10,839	9,806	9,194	1,531	1,454	185,769	191,687	-3.1%
7,818	4,973	18,186	10,245	17,450	9,821	2,195	1,115	409,115	171,572	-138.5%

---

DBRP net assets held in trust for benefits at June 30, 2004 amounted to \$3.0 billion, an increase of \$334 million (12.4 percent) from \$2.7 billion at June 30, 2003.

Additions to the PERS-DBRP net assets held in trust for benefits include employer, member, and state contributions and investment income. For the fiscal year ended June 30, contributions increased from \$120.6 million in fiscal year 2003 to \$121.3 million in fiscal year 2004, for an increase of \$683 thousand (0.57 percent). Contributions increased due to increased salaries being reported to PERS and an increased number of participating employers. The plan recognized net investment income of \$360.2 million for the fiscal year ended June 30, 2004 compared with net investment income of \$167.3 million for the fiscal year ended June 30, 2003. The increases in investment income are mainly due to the turnaround of the equity market.

Deductions from the PERS-DBRP net assets held in trust for benefits primarily include retirement benefits, refunds/distributions, administrative expenses and miscellaneous expenses. For fiscal year 2004, benefits amounted to \$132.7 million, an increase of \$10.5 million (8.5 percent) from fiscal year 2003. The increase in benefit payments was due to the increase in benefit recipients and the average recipient's benefit. For fiscal year 2004, the costs of administering the plan's benefits amounted to \$2.8 million, an increase of \$571 thousand (25.3 percent) from fiscal year 2003. The increase in administrative expenses for the fiscal year 2004 was mostly due to the WEB System expenditures and the corresponding amortization. The decrease in miscellaneous expenses was due to the conclusion of the initial transfers from the DBRP to the DCRP and the ORP, which occurred in fiscal year 2003.

An actuarial valuation of the PERS-DBRP assets and benefit obligations is performed every two years. At July 1, 2004, the date of the most recent actuarial valuation, the funded status of the plan decreased to 86.72 percent from 99.97 percent at July 1, 2002. The PERS-DBRP actuarial value of assets is less than actuarial liabilities by \$466.8 million at July 1, 2004, compared with \$983 thousand at July 1, 2002. The decrease in funded status as of the last actuarial valuation is a result of the valuation recognizing the previous four-year investment performance.

### **JRS**

*The JRS provides retirement, disability and death benefits for all Montana judges of the district courts, justices of the Supreme Court and the Chief Water Judge. Member and employer contributions and earnings on investments fund the benefits of the plan.* The JRS net assets held in trust for benefits at June 30, 2004 amounted to \$45.0 million, an increase of \$5.2 million (13.0 percent) from \$39.8 million at June 30, 2003.

Additions to the JRS net assets held in trust for benefits include member and employer contributions and investment income. For the fiscal year ended June 30, 2004, contributions increased from \$1.3 million in fiscal year 2003 to \$1.6 million in fiscal year 2004, for an increase of \$241 thousand (18.0 percent). Contributions increased because the total compensation reported for active members increased. The plan recognized net investment income of \$5.2 million for the fiscal year ended June 30, 2004 compared with net investment income of \$2.7 million for the fiscal year ended June 30, 2003. The increase in investment income is mainly due to the turnaround of the equity market.

Deductions from the JRS net assets held in trust for benefits mainly include retirement

---

benefits and administrative expenses. For fiscal year 2004, benefits amounted to \$1.7 million, a increase of \$118 thousand (7.6 percent) from fiscal year 2003. The increase in benefit payments was due to the increase in the average recipient's benefit. The increase in administrative expenses for the fiscal year 2004 was mostly due to the WEB System expenditures and the corresponding amortization.

An actuarial valuation of the JRS assets and benefit obligations is performed every two years. At July 1, 2004, the date of the most recent actuarial valuation, the funded status of the plan decreased to 129.98 percent from 145.60 percent at July 1, 2002. The JRS actuarial assets were more than actuarial liabilities by \$10.4 million at July 1, 2004, compared with \$14.1 million actuarial surplus at July 1, 2002. The decrease in funded status as of the last actuarial valuation is a result of the valuation recognizing the previous four-year investment performance.

### **HPORS**

*The HPORS provides retirement, disability and death benefits for members of the Montana Highway Patrol. Member and employer contributions, registration fees and earnings on investments fund the benefits of the plan. The HPORS net assets held in trust for benefits at June 30, 2004 amounted to \$78.6 million, an increase of \$7.5 million (10.5 percent) from \$71.1 million at June 30, 2003.*

Additions to the HPORS net assets held in trust for benefits include employer, and member contributions, registration fees and investment income. For the fiscal year ended June 30, contributions decreased from \$4.0 million in fiscal year 2003 to \$3.9 million in fiscal year 2004, a decrease of \$75 thousand (1.9 percent). Contributions decreased because the

number of participating members contributing to the plan decreased. The plan recognized net investment income of \$9.3 million for the fiscal year ended June 30, 2004 compared with net investment income of \$4.6 million for the fiscal year ended June 30, 2003. The increase in investment income is mainly due to the turnaround in the equity market.

Deductions from the HPORS net assets held in trust for benefits mainly include retirement benefits, refunds/distributions and administrative expenses. For fiscal year 2004, benefits amounted to \$5.5 million, an increase of \$333 thousand (6.5 percent) from fiscal year 2003. The increase in benefit payments was due to the increase in benefit recipients and the increase in the average recipient's benefit. The increase in administrative expenses for the fiscal year 2004 was mostly due to the WEB System expenditures and the corresponding amortization.

An actuarial valuation of the HPORS assets and benefit obligations is performed every two years. At July 1, 2004, the date of the most recent actuarial valuation, the funded status of the plan decreased to 76.01 percent from 86.17 percent at July 1, 2002. The HPORS actuarial assets were less than actuarial liabilities by \$25.0 million at July 1, 2004, compared with \$13.1 million at July 1, 2002. The decrease in funded status as of the last actuarial valuation is a result of the valuation recognizing the previous four-year investment performance.

### **SRS**

*The SRS provides retirement, disability and death benefits for all Department of Justice criminal investigators hired after July 1, 1993 and all Montana sheriffs. Member and employer contributions and earnings on investments fund the benefits of the plan. The*

---

SRS net assets held in trust for benefits at June 30, 2004 amounted to \$140.5 million, an increase of \$16.5 million (13.3 percent) from 124.0 million at June 30, 2003.

Additions to the SRS net assets held in trust for benefits include member and employer contributions and investment income. For the fiscal year ended June 30, contributions increased from \$5.2 million in fiscal year 2003 to \$5.4 million in fiscal year 2004, for an increase of \$192 thousand (3.7 percent). Contributions increased because the number of participating members contributing to the plan increased and the total compensation reported for active members increased. The plan recognized net investment income of \$16.4 million for the fiscal year ended June 30, 2004 compared with net investment income of \$8.2 million for the fiscal year ended June 30, 2003. The increase in investment income is mainly due to the turnaround of the equity market.

Deductions from the SRS net assets held in trust for benefits mainly include retirement benefits, refunds/distributions and administrative expenses. For fiscal year 2004, benefits amounted to \$4.9 million, an increase of \$595 thousand (13.8 percent) from fiscal year 2003. The increase in benefit payments was mainly due to an increase in benefit recipients. The increase in administrative expenses for the fiscal year 2004 was mostly due to the WEB System expenditures and the corresponding amortization.

An actuarial valuation of the SRS assets and benefit obligations is performed every two years. At July 1, 2004, the date of the most recent actuarial valuation, the funded status of the plan decreased to 94.90 percent from 113.95 percent at July 1, 2002. The SRS actuarial assets were more than actuarial liabilities by \$17.0 million at July 1, 2002, com-

pared with \$7.6 million actuarial surplus at July 1, 2004. The decrease in funded status as of the last actuarial valuation is a result of the valuation recognizing the previous four-year investment performance.

## **GWPORS**

*The GWPORS provides retirement, disability and death benefits for game wardens, warden supervisory personnel and state peace officers. Member and employer contributions and earnings on investments fund the benefits of the plan.* The GWPORS net assets held in trust for benefits at June 30, 2004 amounted to \$45.2 million, an increase of \$7.8 million (20.9 percent) from 37.4 million at June 30, 2003.

Additions to the GWPORS net assets held in trust for benefits include member and employer contributions and investment income. For the fiscal year ended June 30, contributions increased from \$4.1 million in fiscal year 2003 to \$4.7 million in fiscal year 2004, for an increase of \$607 thousand (14.7 percent). Contributions increased because the number of members contributing to the plan increased. The plan recognized net investment income of \$5.1 million for the fiscal year ended June 30, 2004 compared with net investment income of \$2.5 million for the fiscal year ended June 30, 2003. The increase in investment income is mainly due to the turnaround of the equity market.

Deductions from the GWPORS net assets held in trust for benefits mainly include retirement benefits, refunds/distributions and administrative expenses. For fiscal year 2004, benefits amounted to \$1.4 million, an increase of \$144 thousand (10.9 percent) from fiscal year 2003. The increase in benefit payments was due to the increase in benefit recipients and the increase in the average recipient's benefit. The increase in administra-

---

tive expenses for the fiscal year 2004 was mostly due to the WEB System expenditures and the corresponding amortization.

An actuarial valuation of the GWPORS assets and benefit obligations is performed every two years. At July 1, 2004, the date of the most recent actuarial valuation, the funded status of the plan decreased to 89.86 percent from 99.03 percent at July 1, 2002. The GWPORS actuarial assets were less than actuarial liabilities by \$5.1 million at July 1, 2004, compared with \$379 thousand at July 1, 2002. The decrease in funded status as of the last actuarial valuation is a result of the valuation recognizing the previous four-year investment performance.

### **MPORS**

*The MPORS provides retirement, disability and death benefits for municipal police officers employed by first- and second-class cities and other cities that adopt the plan. Member, employer and state contributions and earnings on investments fund the benefits of the plan.* The MPORS net assets held in trust for benefits at June 30, 2004 amounted to \$148.4 million, an increase of \$18.1 million (14.0 percent) from 130.2 million at June 30, 2003.

Additions to the MPORS net assets held in trust for benefits include employer, member, and state contributions and investment income. For the fiscal year ended June 30, contributions increased from \$12.6 million in fiscal year 2003 to \$13.1 million in fiscal year 2004, for an increase of \$579 thousand (4.6 percent). Contributions increased because the number of members contributing to the plan increased and the total compensation reported for active members increased. The plan recognized net investment income of \$16.4 million for the fiscal year ended June 30, 2004 compared with net investment income of \$8.5

million for fiscal year ended June 30, 2003. The increase in investment income is mainly due to the turnaround of the equity market.

Deductions from the MPORS net assets held in trust for benefits mainly include retirement benefits, refunds/distributions and administrative expenses. For fiscal year 2004, benefits amounted to \$10.9 million, an increase of \$459 thousand (4.4 percent) from fiscal year 2003. The increase in benefit payments was due to the increase in benefit recipients and the increase in the average recipient's benefit. The increase in administrative expenses for the fiscal year 2004 was mostly due to the WEB System expenditures and the corresponding amortization.

An actuarial valuation of the MPORS assets and benefit obligations is performed every two years. At July 1, 2004, the date of the most recent actuarial valuation, the funded status of the plan decreased to 57.48 percent from 63.27 percent at July 1, 2002. The MPORS actuarial assets were less than actuarial liabilities by \$110.6 million at July 1, 2004, compared with \$83.3 million actuarial liabilities at July 1, 2002. The decrease in funded status as of the last actuarial valuation is a result of the valuation recognizing the previous four-year investment performance.

### **FURS**

*The FURS provides retirement, disability and death benefits for firefighters employed by first- and second-class cities and other cities that adopt the plan, and firefighters hired by the Montana Air National Guard on or after October 1, 2001. Member, employer, and state contributions and earnings on investments fund the benefits of the plan.* The FURS net assets held in trust for benefits at June 30, 2004 amounted to \$141.1 million, an increase of \$17.4 million (14.1 percent) from \$123.7 million at June 30, 2003.



---

Additions to the FURS net assets held in trust for benefits include employer, member, and state contributions and investment income. For the fiscal year ended June 30, contributions increased from \$10.9 million in fiscal year 2003 to \$11.5 million in fiscal year 2004, an increase of \$593 thousand (5.4 percent). Contributions increased because total compensation reported for active members increased. The plan recognized net investment income of \$15.7 million for the fiscal year ended June 30, 2004 compared with net investment income of \$8.1 million for the fiscal year ended June 30, 2003. The increase in investment income is mainly due to the turnaround in the equity market.

Deductions from the FURS net assets held in trust for benefits mainly include retirement benefits, refunds/distributions and administrative expenses. For fiscal year 2004, benefits amounted to \$9.7 million, an increase of \$593 thousand (6.5 percent) from fiscal year 2003. The increase in benefit payments was due to the increase in benefit recipients and the increase in the average recipient's benefit. The increase in administrative expenses for the fiscal year 2004 was mostly due to the WEB System expenditures and the corresponding amortization.

An actuarial valuation of the FURS assets and benefit obligations is performed every two years. At July 1, 2004, the date of the most recent actuarial valuation, the funded status of the plan decreased to 62.44 percent from 68.9 percent at July 1, 2002. The FURS actuarial assets were less than actuarial liabilities by \$85.5 million at July 1, 2004, compared with \$61.6 million actuarial liability at July 1, 2002. The decrease in funded status as of the last actuarial valuation is a result of the valuation recognizing the previous four-year investment performance.

## **VFCA**

*The VFCA provides retirement, disability and death benefits for volunteer firefighters who are members of eligible volunteer fire companies in unincorporated areas. State contributions and earnings on investments fund the benefits of the plan.* The VFCA net assets held in trust for benefits at June 30, 2004 amounted to \$20.1 million, an increase of \$2.2 million (12.3 percent) from \$17.9 million at June 30, 2003.

Additions to the VFCA net assets held in trust for benefits include state contributions and investment income. For the fiscal year ended June 30, contributions increased from \$1.3 million in fiscal year 2003 to \$1.4 million in fiscal year 2004, an increase of \$124 thousand (9.5 percent). Contributions increased because there was an increase in the fire insurance premium taxes collected. The plan recognized net investment income of \$2.3 million for the fiscal year ended June 30, 2004 compared with net investment income of \$1.3 million for the fiscal year ended June 30, 2003. The increase in investment income is mainly due to the turnaround in the equity market.

Deductions from the VFCA net assets held in trust for benefits mainly include retirement benefits, supplemental insurance payments and administrative expenses. For fiscal year 2004, benefits amounted to \$1.5 million, an increase of \$67 thousand (4.7 percent) from fiscal year 2003.

An actuarial valuation of the VFCA assets and benefit obligations is performed every two years. At July 1, 2004, the date of the most recent actuarial valuation, the funded status of the plan decreased to 69.94 percent from 71.82 percent at July 1, 2002. The VFCA actuarial assets were less than actuarial liabilities by \$8.6 million at July 1, 2004,

---

compared with \$7.6 million at July 1, 2002. The decrease in funded status as of the last actuarial valuation is a result of the valuation recognizing the previous four-year investment performance.

## ***Actuarial Valuations and Funding Progress***

An actuarial valuation of each of the PERB's defined benefit plans is performed every two years. At the date of the most recent actuarial valuation, July 1, 2004, the funded status of each of the plans is shown in the Schedule of Funding Progress on page A-60.

The PERB funding objective is to meet long-term benefit obligations through investment income and contributions. Accordingly, the collection of employer and member contributions, and the income from investments provide the reserves needed to finance future retirement benefits. Since investment earnings are critical to the defined benefit plans' funding, the market decline and associated investment losses in fiscal year 2001 and fiscal year 2002 have deteriorated the plans' funding. The investment losses have reduced the assets available to pay previously incurred benefit obligations. The investment losses have increased the unfunded liability of the plans. Public pension plans are considered actuarially sound if the unfunded accrued actuarial liability amortization period is less than 30 years. Montana's constitution requires that public retirement plans be funded on an actuarially sound basis.

The PERB has been concerned with the funding of three of the eight defined benefit retirement plans administered. The three plans are the PERS - Defined Benefit Retirement Plan (PERS-DBRP), the Game Wardens' and Peace Officers' Retirement System

(GWPORS) and the Sheriffs' Retirement System (SRS). These plans' statutory contribution rates are able to pay the normal cost of the plan, but are insufficient to pay off unfunded liability. Based on the PERB's June 30, 2004 Actuarial Valuations the unfunded liability in these three plans will not be amortized in 30 years. As of June 30, 2004, the estimated shortfalls in statutory contributions rates were 1.19% in PERS-DBRP, 0.23% in GWPORS, and 2.15% in SRS. The Board has drafted legislation for the 2005 Legislative Session to address these insufficiencies.

Funding ratios range from a high of 129.98 percent to a low of 57.48 percent. The Schedule of Funding Progress on page A-60 shows the July 1, 2004 funding ratios compared with the ratios at July 1, 2002 and July 1, 2000. The table also shows the amount by which actuarial assets exceeded or fell short of actuarial liabilities. The funding ratio decline is a result of the overall investment performance of the past four years. At July 1, 2004, the actuarial value of assets exceeded the market value of assets by \$21 million compared with \$611 million at July 1, 2000.

## ***Defined Contribution Plans***

The MPERA administers two defined contribution plans: The Public Employees' Retirement System - defined contribution retirement plan (PERS-DCRP) and the Deferred Compensation (457) Plan. The schedules of Net Assets and Changes in Net Assets for the two defined contribution plans are on the following page.

### **PERS-DCRP**

*The PERS-DCRP is established under Section 401(a) of the Internal Revenue Code. This plan provides retirement benefits for plan members. This plan was available to all*

## Fiduciary Net Assets - Defined Contribution Plans

**As of June 30, 2004** - and comparative totals for June 30, 2003

(dollars in thousands)

	PER5-DCRP		457-PLAN		TOTAL		Total %
	2004	2003	2004	2003	2004	2003	Change
<b>Assets:</b>							
Cash and Receivables	365	7,246	408	3,479	773	10,725	-92.8%
Investments	20,480	9,239	224,376	205,028	244,856	214,267	14.3%
Intangible Assets	6		157		163		100.0%
<b>Total Assets</b>	<b>20,851</b>	<b>16,485</b>	<b>224,941</b>	<b>208,507</b>	<b>245,792</b>	<b>224,992</b>	<b>9.2%</b>
<b>Liabilities:</b>							
Other Payables	1,553	1,604	192	167	1,745	1,771	-1.5%
<b>Total Liabilities</b>	<b>1,553</b>	<b>1,604</b>	<b>192</b>	<b>167</b>	<b>1,745</b>	<b>1,771</b>	<b>-1.5%</b>
<b>Total Net Assets</b>	<b>19,298</b>	<b>14,881</b>	<b>224,749</b>	<b>208,340</b>	<b>244,047</b>	<b>223,221</b>	<b>9.3%</b>

## Changes In Fiduciary Net Assets - Defined Contribution Plans

**For the year ended June 30, 2004** - and comparative totals for June 30, 2003

(dollars in thousands)

	PER5-DCRP		457-PLAN		TOTAL		Total %
	2004	2003	2004	2003	2004	2003	Change
<b>Additions:</b>							
Contributions	4,704	16,551	14,931	15,026	19,635	31,577	-37.8%
Investment Income (Loss)	2,381	551	16,152	8,541	18,533	9,092	103.8%
Prior Period Adjustment			741		741		100.0%
<b>Total Additions</b>	<b>7,085</b>	<b>17,102</b>	<b>31,824</b>	<b>23,567</b>	<b>38,909</b>	<b>40,669</b>	<b>-4.3%</b>
<b>Deductions:</b>							
Refunds/Distributions	2,240	629	14,446	10,648	16,686	11,277	48.0%
Administrative Expenses	214	552	170	218	384	770	-50.1%
Miscellaneous Expenses	214	14	800	780	1,014	794	27.8%
<b>Total Deductions</b>	<b>2,668</b>	<b>1,195</b>	<b>15,416</b>	<b>11,646</b>	<b>18,084</b>	<b>12,841</b>	<b>40.8%</b>
<b>Incr/(Decr) in Net Assets</b>	<b>4,417</b>	<b>15,907</b>	<b>16,408</b>	<b>11,921</b>	<b>20,825</b>	<b>27,828</b>	<b>-25.2%</b>

active PERS members effective July 1, 2002. The plan member and employer contributions and earnings on investments fund the benefits of the plan.

The PERB has received a long-term INTERCAP loan through the Montana Department of Administration from the BOI to fund the plan start-up and implementation costs. As of June 30, 2004, the loan balance is \$1.4 million. The loan was renegotiated in 2004 and the term extended to 2018.

The plan net assets held in trust for benefits at June 30, 2004 amounted to \$19.3 million, an

increase of \$4.4 million (29.7 percent) from \$14.9 at June 30, 2003.

Additions to the Defined Contribution Retirement Plan net assets held in trust for benefits include contributions and investment income. Contributions decreased \$11.8 million (71 percent) from \$16.5 million in fiscal year 2003 to \$4.7 million in fiscal year 2004. Contributions decreased because the initial window for the majority of participants closed at the end of fiscal year 2003. The plan recognized net investment income of \$2.4 million fiscal year 2004, up from \$551 thousand in

---

fiscal year 2003.

Deductions from the Defined Contribution Retirement Plan net assets mainly include member refunds/distributions, administrative expenses and miscellaneous expenses. Refunds/distributions increased from \$629 thousand in fiscal year 2003 to \$2.2 million in fiscal year 2004. The \$1.6 million increase in refunds/distributions from 2003 to 2004 was due to the majority of the existing members not transferring to the DCRP until the end of 2003 and any refunds/distributions from those members did not occur until 2004. The costs of administering the plan decreased from \$552 thousand in fiscal year 2003 to \$214 thousand in fiscal year 2004, a decrease of \$337.7 thousand (61.0 percent) from fiscal year 2003. The decrease in administrative costs was mainly due to a reduction in initial plan implementation costs experienced in the first year of operation.

### **Deferred Compensation (457) Plan**

*The Deferred Compensation Plan is established under Section 457 of the Internal Revenue Code. This plan is voluntary and provides supplemental retirement benefits for plan participants. The Deferred Compensation Plan is funded by contributions and by investment earnings. The plan net assets held in trust for benefits at June 30, 2004 amounted to \$224.8 million, an increase of \$16.4 million (8.0 percent) from \$208 million at June 30, 2003.*

Additions to the Deferred Compensation Plan net assets held in trust for benefits include contributions and investment income. For fiscal year 2004, contributions decreased from those of fiscal year 2003 from \$15.0 million to \$14.9 million, a decrease of \$95 thousand (0.6 percent). Contributions decreased because of decreased contributions by current participants. The majority of participants are

state employees and there has been a pay freeze on state wages. The plan recognized net investment income of \$16.1 million for fiscal year 2004 compared with net investment income of \$8.5 million for fiscal year 2003. The increase in investment income is mainly due to the turnaround in the equity market.

Deductions from the Deferred Compensation Plan net assets mainly include member and beneficiary refunds/distributions, administrative expenses and miscellaneous expenses. For fiscal year 2004, refunds/distributions amounted to \$14.4 million, an increase of \$3.8 million (35.6 percent) from \$10.6 at June 30, 2003.

# Public Employees' Retirement Board

A Component Unit of the State of Montana

## Statement of Fiduciary Net Assets - Pension Trust Funds

as of June 30, 2004 - with comparative totals for June 30, 2003

	PERS-08RP	JRS	HPORS	SRS	GWORS	MPORS
<b>Assets</b>						
Cash and Short-term Investments	\$ 103,722,614	1,733,947	2,462,269	5,102,247	2,536,482	3,405,348
Securities Lending Collateral (Note A5)	141,310,880	2,237,046	3,951,832	6,996,907	2,209,162	7,143,243
Receivables						
Interest	10,400,288	152,929	270,165	477,732	150,522	488,416
Accounts Receivable	1,431,549		3	131,299	3,138	53,300
Due from Other Funds	287,637	7,020	14,165	1,521	4,544	
Due from Primary Government	73,933					7,208,135
Advances to Other Funds	85,500					
Notes Receivable	326,441					
<i>Total Receivables</i>	<i>12,605,348</i>	<i>159,949</i>	<i>284,333</i>	<i>610,552</i>	<i>158,204</i>	<i>7,749,851</i>
Investments, at fair value (Note A5)						
Montana Domestic Equity Pool (MDEP)	1,469,962,550	21,738,817	38,192,152	68,112,284	21,520,575	69,175,438
Retirement Fund Bond Pool (RFBP)	805,839,505	13,023,958	23,017,674	40,680,215	12,836,952	41,583,960
Montana International Pool (MTIP)	434,916,502	6,393,440	11,296,308	20,126,747	6,371,537	20,468,213
Montana Private Equity Pool (MPEP)	128,797,001	1,906,253	3,375,008	5,935,958	1,856,063	6,104,783
Equity Index Fund	23					
Real Estate Investments	8,409,210					
Mortgages & Commercial Loans						
net of Accumulated Mortgage Discount	66,755,267					
Defined Contributions Fixed Investments						
Defined Contributions Variable Investments						
Deferred Compensation Life Insurance						
<i>Total Investments</i>	<i>2,914,680,058</i>	<i>43,062,468</i>	<i>75,881,142</i>	<i>134,855,204</i>	<i>42,585,127</i>	<i>137,322,394</i>
Capital Assets						
Property and Equipment, at cost,						
net of Accumulated Depreciation (Note A2)	1,436					
Intangible Assets, at cost,						
net of Amortization Expense (Note A2)	535,229	5,755	5,755	5,755	5,755	5,755
<i>Total Capital Assets</i>	<i>536,665</i>	<i>5,755</i>	<i>5,755</i>	<i>5,755</i>	<i>5,755</i>	<i>5,755</i>
<b>Total Assets</b>	<b>3,172,855,565</b>	<b>47,199,165</b>	<b>82,585,331</b>	<b>147,570,665</b>	<b>47,484,730</b>	<b>155,626,592</b>
<b>Liabilities</b>						
Securities Lending Collateral Liability	141,310,880	2,237,046	3,951,832	6,996,907	2,209,162	7,143,243
Accounts Payable	438,778			18,376	2,540	5,546
Due to Other Funds	72,790	6,704	24,788	50,970	36,580	65,051
Due to Primary Government	56,579					
Advances from Primary Government (Note C)						
Advances from Other Funds						
Deferred Revenue	51,408			392	198	1,987
Compensated Absences	246,317					45
<i>Total Liabilities</i>	<i>142,176,752</i>	<i>2,243,750</i>	<i>3,976,620</i>	<i>7,066,645</i>	<i>2,248,480</i>	<i>7,215,872</i>
<b>Net Assets Held in Trust for Pension Benefits</b>						
(see schedule of funding progress, page 72)	\$ 3,030,678,813	44,955,415	78,608,711	140,504,020	46,246,250	148,410,720

The notes to the financial statements are an integral part of this statement.

Defined Benefit Pension Plans			Defined Contribution Plans			Total Pension	Total Pension
Total Defined Benefit Pension Plans			Total Defined Contribution Plans			Trust Funds	Trust Funds
FURS	VFCA	Pension Plans	PERS-DCRP	457 Plan	Plans	2004	2003
3,415,488	181,368	122,559,764	337,000	407,043	744,043	123,303,807	97,053,434
6,800,570	963,152	171,612,792				171,612,792	109,604,210
465,022	66,230	12,471,304				12,471,304	13,533,006
42,469		1,661,758	102	698	800	1,662,558	5,834,443
11,411	24,170	350,468	27,741		27,741	378,209	5,740,939
6,532,708	1,434,068	15,248,844				15,248,844	12,913,925
		85,500				85,500	
		326,441				326,441	461,741
7,051,610	1,524,468	30,144,315	27,843	698	28,541	30,172,856	38,474,054
65,850,978	9,220,831	1,763,773,625				1,763,773,625	1,562,972,388
39,592,465	5,617,221	982,191,950				982,191,950	991,847,438
19,468,794	2,746,116	521,777,657				521,777,657	270,217,811
5,813,454	848,351	154,636,871				154,636,871	180,590,596
		23				23	17
		8,409,210				8,409,210	7,246,333
		66,755,267				66,755,267	112,078,541
			914,437	143,162,113	144,076,550	144,076,550	138,094,775
			19,565,885	81,201,755	100,767,440	100,767,440	76,160,188
				12,316	12,316	12,316	12,316
130,725,691	18,432,519	3,497,544,603	20,480,122	224,376,184	244,856,306	3,742,400,909	3,339,220,403
		1,436				1,436	1,898
5,755		569,759	5,756	157,039	162,795	732,554	
5,755	-	571,195	5,756	157,039	162,795	733,990	
147,999,114	21,101,507	3,822,432,669	20,850,721	224,440,964	245,791,685	4,068,224,354	3,584,353,999
6,800,570	963,152	171,612,792				171,612,792	109,604,210
		465,240	4,612	168,910	173,522	638,762	3,132,956
48,773	43,032	348,688	27,222	2,299	29,521	378,209	5,740,939
		56,579	25,210	778	25,988	82,567	160,859
			1,390,195		1,390,195	1,390,195	1,400,195
			85,500		85,500	85,500	
3,564		57,549				57,549	254,339
		246,362	19,937	20,014	39,951	286,313	308,420
6,852,907	1,006,184	172,787,210	1,552,676	192,001	1,744,677	174,531,887	120,601,918
141,146,207	20,095,323	3,649,645,459	19,298,045	224,748,963	244,047,008	3,893,692,467	3,463,752,081

# Public Employees' Retirement Board

*A Component Unit of the State of Montana*

## Statement of Changes in Fiduciary Net Assets - Pension Trust Funds

for the year ended June 30, 2004 - with comparative totals for June 30, 2003

	PERS-D8RP	JRS	HPDRS	SRS	GWPDRS	MPORS
<b>Additions</b>						
<b>Contributions (Note D)</b>						
Employer	\$ 57,802,323	1,136,528	2,858,523	2,679,465	2,021,084	3,611,571
Plan Member	61,910,738	442,700	742,719	2,656,216	2,688,934	2,263,424
Membership Fees	130					
Interest Reserve Buyback	753,647		186	29,298	25,468	50,163
Retirement Incentive Program	427,579			4,180		
Registration Fee Collections			348,137			
Miscellaneous Revenue	1,252			20		
State Contributions	402,566					7,208,135
Nonvested Member Forfeitures						
<b>Total Contributions</b>	<b>121,298,235</b>	<b>1,579,228</b>	<b>3,949,565</b>	<b>5,369,179</b>	<b>4,735,486</b>	<b>13,133,293</b>
<b>Investments (Note A5)</b>						
Net Appreciation (Depreciation)						
in Fair Value of Investments	203,084,283	2,935,065	4,983,370	9,585,490	3,228,534	9,671,766
Interest	143,499,965	2,107,014	3,973,360	6,196,140	1,646,335	6,076,103
Dividends	12,166,404	253,216	449,232	790,260	244,270	793,393
Investment Expense	(3,761,001)	(51,440)	(91,148)	(160,968)	(50,623)	(163,075)
<b>Net Investment Income</b>	<b>359,989,651</b>	<b>5,243,855</b>	<b>9,314,814</b>	<b>16,390,922</b>	<b>5,068,516</b>	<b>16,378,187</b>
<b>Securities Lending Income</b>						
Securities Lending Income	1,487,479	23,708	42,236	74,189	23,012	75,446
Securities Lending Rebate and Fees	(1,211,320)	(19,467)	(34,688)	(60,872)	(18,825)	(61,990)
<b>Net Securities Lending Income</b>	<b>276,159</b>	<b>4,241</b>	<b>7,548</b>	<b>13,317</b>	<b>4,187</b>	<b>13,456</b>
<b>Total Net Investment Income</b>	<b>360,265,810</b>	<b>5,248,096</b>	<b>9,322,362</b>	<b>16,404,239</b>	<b>5,072,703</b>	<b>16,391,643</b>
<b>Total Additions</b>	<b>481,564,045</b>	<b>6,827,324</b>	<b>13,271,927</b>	<b>21,773,418</b>	<b>9,808,189</b>	<b>29,524,936</b>
<b>Deductions (Note D)</b>						
Benefits	132,683,144	1,670,457	5,482,910	4,902,832	1,459,817	10,885,372
Refunds/Distributions	10,913,131		143,713	305,914	500,746	336,546
Refunds to Other Plans	398,049		152,213	12,108	3,728	51,662
Transfers to DCRP	1,295,269					
Transfers to ORP	188,331					
Supplemental Insurance Payments						
Administrative Expenses	2,825,205	13,965	30,888	55,449	41,759	70,173
Miscellaneous Expenses						
<b>Total Deductions</b>	<b>148,303,129</b>	<b>1,684,422</b>	<b>5,619,724</b>	<b>5,276,302</b>	<b>2,006,050</b>	<b>11,343,753</b>
<b>Net Increase (Decrease)</b>	<b>333,260,916</b>	<b>5,143,902</b>	<b>7,452,203</b>	<b>16,497,116</b>	<b>7,802,139</b>	<b>18,181,183</b>
<b>Net Assets Held in Trust for Pension Benefits</b>						
Beginning of Year	2,696,362,315	39,793,477	71,130,488	123,995,150	37,428,633	130,225,151
Prior Period Adjustment	1,055,582	20,036	26,020	13,754	15,478	4,386
End of Year	\$ 3,030,678,813	44,955,415	78,608,711	140,504,020	45,246,250	148,410,720

The notes to the financial statements are an integral part of this statement.

Defined Benefit Pension Plans			Defined Contribution Plans			Total Pension Trust Funds	Total Pension Trust Funds
FURS	VFCA	Total Defined Benefit Pension Plans	PERS-DCRP	457 Plan	Total Defined Contribution Plans	2004	2003
2,795,612		72,905,106	1,780,778	39,956	1,830,734	74,725,840	77,932,206
2,212,117		72,916,848	2,661,190	14,623,403	17,284,593	90,201,441	97,256,288
		130				130	161
1,978		660,740				660,740	932,995
		431,759				431,759	404,473
		348,137				348,137	353,589
		1,272	127,255	267,353	394,608	395,880	257,927
6,532,708	1,434,068	15,577,477				15,577,477	14,503,752
			135,246		135,246	135,246	31,188
11,543,415	1,434,068	163,041,469	4,704,469	14,930,712	19,635,181	182,676,650	191,672,579
9,289,172	1,290,810	244,048,490	1,953,417	9,511,599	11,465,016	255,513,506	68,646,772
5,787,212	891,528	170,177,662	427,911	7,091,810	7,519,721	177,697,383	129,670,177
757,844	108,773	20,563,392				20,563,392	17,982,465
(155,476)	(21,976)	(4,455,707)		(451,198)	(451,198)	(4,906,905)	(4,419,721)
15,678,757	2,269,135	430,333,837	2,381,328	16,152,211	18,533,539	448,867,376	211,879,693
71,963	10,117	1,808,150				1,808,150	1,981,501
(59,112)	(8,336)	(1,474,610)				(1,474,610)	(1,606,951)
12,851	1,781	333,540	-	-	-	333,540	374,550
15,691,608	2,270,916	430,667,377	2,381,328	16,152,211	18,533,539	449,200,916	212,254,243
27,234,023	3,704,984	593,708,846	7,085,797	31,082,923	38,168,720	631,877,566	403,926,822
9,674,137	1,478,648	168,247,317				168,247,317	155,456,469
76,678		12,276,728	2,239,701	14,445,666	16,685,367	28,963,095	22,775,762
1,956		619,715				619,715	340,797
		1,295,269				1,295,269	15,990,427
		188,331				188,331	5,957,197
	12,000	12,000				12,000	12,000
53,419	40,097	3,130,954	213,998	169,673	383,671	3,514,625	3,199,441
			214,218	600,218	1,014,436	1,014,436	793,948
9,806,188	1,530,746	185,770,314	2,667,917	15,415,557	18,083,474	203,853,788	204,526,041
17,427,834	2,174,239	407,938,532	4,417,880	15,667,366	20,085,246	428,023,778	199,400,781
123,696,561	17,893,840	3,240,530,624	14,880,418	208,341,039	223,221,457	3,463,752,081	3,264,351,300
21,812	21,235	1,126,303	(253)	740,558	740,305	1,916,608	
141,146,207	20,095,323	3,648,645,459	19,298,045	224,748,963	244,047,008	3,893,692,467	3,463,752,081



---

# Public Employees' Retirement Board

## *A Component Unit of the State of Montana*

### **Notes to the Financial Statements**

*for the Fiscal Years Ended June 30, 2004 and 2003*

The Public Employees' Retirement Board (PERB) administers ten retirement plans and the related member education plans. The retirement plans are eight defined benefit plans and two defined contribution plans. The *defined benefit* retirement plans are the Public Employees' Retirement System (PERS-DBRP), Judges' Retirement System (JRS), Highway Patrol Officers' Retirement System (HPORS), Sheriffs' Retirement System (SRS), Game Wardens' and Peace Officers' Retirement System (GWPORS), Municipal Police Officers' Retirement System (MPORS), Firefighters' Unified Retirement System (FURS), and the Volunteer Firefighters' Compensation Act (VFCA). The *defined contribution* retirement plans are the Public Employees' Retirement System (PERS-DCRP) and the Deferred Compensation (IRC § 457) Plan. The PERS-DCRP was implemented as of July 1, 2002. All PERS new hires after July 1, 2002 have a twelve-month window from their date of hire to file an election. The Deferred Compensation Plan is available to employees of the state, university and local political subdivisions that contract with the plan.

PERS members are provided member education as a tool to help them decide between participation in the Defined Benefit Retirement Plan (PERS-DBRP) or the Defined Contribution Retirement Plan (PERS-DCRP). If members are employees of the university system they have a third choice, the Optional Retirement Program (ORP). The plan choice is a one-time irrevocable election. Education is also available for the members who choose

the PERS-DCRP and ORP. This education includes information on investment choices.

The assets of each plan are maintained separately, including member education funds, and may be used only for the payment of benefits to the members and administrative expenses of the appropriate plan, in accordance with the terms of each plan as prescribed in Title 19, of the Montana Code Annotated (MCA). The financial statements are presented by combining the PERS-DBRP and the DBRP Education fund and by combining the PERS-DCRP, the DCRP Education Fund and the Disability Fund. A presentation of each individual fund is shown at the end of the financial section.

#### **A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

##### **1. BASIS OF ACCOUNTING**

The PERB is a discretely presented component unit Pension Trust Fund of the State of Montana financial reporting entity. The Montana Public Employee Retirement Administration (MPERA), staff of the PERB, prepares the accounting records and financial statements for the fiduciary/pension trust funds using the accrual basis of accounting. For the pension trust funds, member contributions are recognized in the period in which contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Revenues are recognized in the accounting period in which

---

they are earned and become measurable. Benefits and refunds/distributions are recognized in the accounting period in which they are due and payable. Expenses are recognized in the period incurred. Administrative expenses are financed through investment earnings on the pension trust fund for the defined benefit plans. Interfund receivables and payables exist at year-end because all defined benefit administrative expenses are accounted for within PERS-DBRP and then allocated to the other defined benefit plans at year-end.

Adjustments to the fiscal year 2004 financial statements consist of prior period adjustments to all plans recording the web based employer reporting software and the applicable depreciation and adjustments to the 457 plan based on more accurate information on the fixed asset account received from State Street Kansas City, the custodial bank.

Participants of the PERS-DCRP are charged, on a quarterly basis, a flat fee plus a basis point fee on their account balance. The flat fee covers the recordkeeping provided by Great West Retirement Services (Great West). The basis point fee is returned to the PERB to cover the PERB's administrative expenses of the plan. The fees returned to the PERB are recorded as *Miscellaneous Revenue* in the financial statements

Participants of the deferred compensation (457) plan are charged fees, quarterly, based on individual account balances. The record keeper, Great West, withholds fees and after payment of the Great West's contractual expenses, the excess fees are submitted to the PERB. The excess fees, recorded as *Miscellaneous*

*Revenue* in the financial statements, are used to pay the PERB's related administrative expenses.

## 2. CAPITAL ASSETS AND EQUIPMENT USED IN OPERATIONS

Assets under \$5,000 are expensed in the year purchased. Assets valued at \$5,000 or more, are recorded at cost less straight-line depreciation over the estimated useful life of five to ten years. Equipment for MPERA consists of a microfiche reader/printer and capital assets include the web based employer reporting software. The accumulated depreciation on our web based reporting system is \$625,560 and \$325,291, respectively as of June 30, 2004 and 2003. The carrying value as of June 30, 2004 and 2003 is \$575,515 and \$875,784, respectively. For the 457 web based employer reporting system the accumulated depreciation is \$3,341 and the carrying value is \$157,039.

## 3. OPERATING LEASE

Operating leases are rental agreements where the payments are chargeable as rent and recorded as administrative expenses. MPERA entered into a 10 year lease for office space in November 2003 at the location of 100 North Park. The lease is payable monthly and includes inflationary adjustments over the period of the lease.

## 4. DERIVATIVES

The defined benefit and defined contribution retirement plans invest in derivatives as authorized by PERB policy. Derivatives are contracts for which the value depends on, or is "derived" from, the value

---

of an underlying asset, reference rate, or index. Derivative reporting in previous years was directed by a Technical Bulletin issued in 1994 by the Governmental Accounting Standards Board (GASB). In 2003 GASB adopted a new standard that is applicable as of June 30, 2003, which superseded the prior standard. The new standard provides disclosure requirements for governmental units holding derivatives that are not reported at fair value in the statement of net assets. If applicable, derivatives are disclosed within the investment summaries that begin on this page.

## 5. METHOD USED TO VALUE INVESTMENTS

Defined benefit retirement plan assets are invested on behalf of the plans by the Montana Board of Investments (BOI), Department of Commerce. Investments are purchased in accordance with the statutorily and constitutionally mandated "prudent expert principle." Investments are reported at fair value. As of June 30, 2004, there were five major diversified pools, the same number as in fiscal year 2003, Montana Short Term Investment Pool (STIP), Retirement Funds Bond Pool (RFBP), Montana International Pool (MTIP), Montana Private Equity Pool (MPEP) and the Montana Domestic Equity Pool (MDEP).

The PERS-DCRP and the deferred compensation plan's fixed assets were invested and managed on behalf of the plan by Pacific Investment Management Company (PIMCO)/State Street Bank Kansas City (SSKC). The third party record keeper, Great West Retirement Services, tracks and reports the daily trading and valuations of all investment options in-

cluding the assets held by the individual mutual fund companies. Investments are reported at fair value as of June 30, 2004. The following are the PERB summaries of the BOI's fiscal year end statements, the PIMCO/SSKC contract and a statement about the variable investments.

**STIP** portfolio may include asset-backed securities, commercial paper, corporate and government securities, repurchase agreements and variable-rate (floating-rate) instruments. These securities provide a diversified portfolio earning a competitive total rate of return. Funds may be invested for relatively short periods. State agencies are legally required to invest in STIP and the PERB elects to have all STIP income automatically reinvested. Investments are reported at fair value based on market prices supplied to the BOI by the BOI's custodial bank. The unit value is fixed at \$1.00. A purchased unit earns income on the purchase date and ceases to earn income on the day before the unit is sold. STIP income reflects the monthly earnings of the STIP portfolio and is distributed on the first calendar day of the month, with the exception of the June distribution. Income for June is distributed on the last calendar day of the month. Administrative expenses incurred by the BOI are charged daily to STIP based on their expenses applicable to STIP. STIP did not participate in any securities lending transactions in fiscal year 2004. STIP investments are required to have the highest rating in the short term category by any Nationally Recognized Statistical Rating Organization. STIP is considered an external investment pool per the Governmental Accounting Standards Board (GASB) Statement No. 31 and is classified as a "2a7-like" pool. STIP is not registered with the Securities

---

and Exchange Commission (SEC) but does operate in a manner consistent with SEC rules. *Disclosure about Derivatives:* STIP holds two types of securities that are required to be disclosed per the GASB: 1) Asset-backed securities are collateralized by a pool of mortgage and non-mortgage assets pledged by the issuer. 2) Variable-rate (floating-rate) securities are sensitive to interest rate changes. STIP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the STIP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received. There are no legal risks that the BOI is aware of regarding any STIP investments.

MDEP portfolio may include common stock, equity index, preferred stock, convertible equity securities, American Depositary Receipts and equity derivatives. The MDEP was established in April 2003. Effective May 1, 2003, the Public Employees', Judges', Highway Patrol Officers', Sheriffs', Game Wardens' and Peace Officers', Municipal Police Officers', Firefighters' Unified and Volunteer Firefighters' retirement funds transferred all the Barclays Global Investors (BGI) S&P 500 Equity Index Fund A and the Dimensional Fund Advisors (DFA) Small Cap Subtrust investments totaling \$740 million, at cost, from the All Other Funds portfolio to the new pool. The pension also exchanged their investment in the Montana Stock Pool (MTCP) for units in the new MDEP. In July 2003, the BOI closed the STIP account and a Stock Performance Index Futures Fund (SPIFF) account was opened to securitize MDEP cash by investing in an equity derivative.

The value of MDEP units purchased by participants increased \$37 million in fiscal year 2004 while the value of MDEP units sold increased by \$86 million based on changes in the market. The fiscal year 2004 and 2003 changes are the result of an asset allocation decision and do not reflect a change from the stated investment policy to increase retirement fund exposure to equity investments. In fiscal year 2004, MDEP participants bought and sold units at a price ranging from \$108 to \$125 per unit. The increase of \$407 million in the change in fair value reflects the equity market appreciation since fiscal year 2003. Investments are presented at fair value. Equity investments, on valuation date, are stated at the closing price of the security's primary exchange. Depending on stock market conditions and the investment officer's decision, MDEP participants may then buy or sell units on the first calendar day of each month. MDEP security transactions are recorded as of trade date rather than settlement date. Because of this generally accepted practice, the MDEP portfolio at June 30 may include receivables from brokers for securities sold but not delivered, and payables to brokers for securities purchased but not received.

On October 11, 2002, the BOI received a summons and complaint regarding the bankruptcy of Owens-Coming. The company seeks a determination that the dividend payments paid from October 1996 through July 2000 represent "fraudulent transfers under Chapter 11 Bankruptcy provisions and applicable state law, and are, therefore, voidable". The complaint states the BOI was the "recipient of dividends in the amount of \$357,099 for the relevant period". The BOI has prepared a response to the complaint.

---

RFBP portfolio includes corporate asset-backed, other corporate, U.S. government mortgage-backed, U.S. government, Yankee securities and cash investments. RFBP investments are presented at fair value. Fair values are determined, primarily, by reference to fair prices supplied to the BOI by its custodial bank, State Street Bank and Trust. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Unit values are calculated weekly and at month end, based on portfolio pricing, to allow for participant transactions to occur as determined by the BOI's Investment Officer. The June 30, 2004 unit value of \$104.32 decreased from the June 30, 2003 unit value of \$110.84. The yield on bonds increased during the fiscal year, which has the effect of decreasing bond prices and the pool unit value. The pension funds were rebalanced in fiscal year 2004 to adjust the portfolios towards the stated equity/fixed income allocation. RFBP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the RFBP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received. Accumulated income is distributed monthly on the first calendar day of the month. Realized portfolio gains/losses are distributed at least annually. Administrative expenses incurred by the BOI are charged daily to RFBP based on the BOI's expenses applicable to RFBP. *Disclosure about Derivatives:* The RFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). These securities are required to be disclosed per the GASB. REMICs

are pass-through vehicles for multiclass mortgage-backed securities. Some REMICs are interest-only strips (IOs).

As of June 30, 2004 and June 30, 2003, Burlington Industries, Inc. presented legal and higher credit risks to the BOI. The BOI owns a Burlington Industries, Inc., \$6 million par, 7.25% bond maturing September 15, 2005. In September 2000, the company announced a reduction of stockholders equity. Due to an increasing senior bank line and declining credit trend, the bond ratings for this issue were downgraded, in May 2001, by the Moody's and Standard & Poor's rating agencies. During fiscal year 2001, the book value of Burlington Industries Inc. was reduced from the August 31, 2000 book value of \$5.6 million to \$2.4 million. Due to the company's filing for Chapter 11 bankruptcy protection on November 11, 2001, the book value was reduced to \$1.2 million. In October 2003, Burlington Industries, Inc. received court approval to sell its assets. Under the company's recovery plan, the BOI received \$1.5 million in August 2004 for its unsecured claim. This transaction reduced the book value to \$0 and generated a gain of \$255 thousand. The BOI is expected to receive additional proceeds for its claim.

As of June 30, 2003, Enron Corp. presented legal and higher credit risks to the BOI. The RFBP holds a \$7 million par 6.40% Enron bond maturing July 15, 2006 and a \$7 million par 6.95% Enron bond maturing July 15, 2028. The combined book value of these securities was \$13.5 million as of November 30, 2001. On December 12, 2001, the Enron Corp. filed for Chapter 11 bankruptcy protection. Accordingly, the November 2001 book value for the two issues was reduced

---

to \$5.6 million as of June 30, 2002. In October 2002, the book value was reduced to \$2.8 million for both issues. In July 2003, both issues were sold, on the market, for a total of \$2.36 million.

The BOI received a summons and complaint, dated September 3, 2002, regarding the sale of a Pennzoil Quaker State, \$5 million par, 6.75% corporate bond maturing April 1, 2009. Deutsche Bank Securities claims a "breach of contract" for the March 25, 2002 sale of the bond at a price of \$94.669 plus accrued interest. Deutsche Bank Securities seeks damages of \$538,632 for the additional costs incurred to acquire the bond from third parties, plus any statutory interest, costs and expenses. On October 1, 2002, Shell Oil Company acquired Pennzoil and subsequently announced a public tender of Pennzoil Quaker State debt. The BOI tendered the Pennzoil Quaker State holdings on October 8, 2002 at a price of \$113.099. The tender was accepted with a settlement date of November 1, 2002. On November 4, 2002, the BOI received \$5.7 million in principal and interest plus \$150,000 as a consent fee. As of September 10, 2004, this matter is still pending.

MTIP portfolio includes equities in four externally managed funds at June 30, 2004: Pyrford International, Schroder Investment Management NA, Barclays Global Investors and Nomura Asset Management U.S.A., Inc. from December 2003. During fiscal year 2004, the MTIP portfolio included investments in six funds. The remaining funds which were discontinued in fiscal year 2004 were: the internally managed fund, BOI Internal International, closed in January 2004 and on October 30, 2003, the BOI voted to replace SG Yamaichi Asset Management,

Co. as an active manager with Nomura Asset Management U.S.A., Inc. The change was effective December 1, 2003. The four funds invest in securities of foreign-based corporations listed on legal and recognized foreign exchanges as well as domestic exchanges. Because transactions are recorded as of the trade date rather than settlement date, the MTIP portfolio may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received. Investments are presented at current U.S. dollar value after conversion from foreign currency by the custodial bank, State Street Bank and Trust. The four funds' cash, receivables, fair value of investment securities, other assets and liabilities are translated into U. S. dollars at the Interactive Data Control 11:00 am EST exchange rate as of the balance sheet date. Unit values are calculated weekly and once a month at the close of the last business day of the month, based upon the fair value of the MTIP equity holdings, other assets and liabilities. Based on the BOI Investment Officer's decision, participants are allowed to buy or sell units on the first business day of each month. Realized gains/losses from the sale of securities and related foreign exchange transactions are retained by each fund. MTIP income is distributed at least monthly to the retirement funds, net of external manager fees and administrative expenses, on the first business day of the following month.

MPEP portfolio includes venture capital, leveraged buyout, mezzanine, distressed debt, special situation and secondary investments. The MPEP was established in April 2002 to allow retirement funds the opportunity to participate in the venture capital and leveraged buyout markets and

---

other private equity investments via a diversified pool. The BOI chose to securitize MPEP cash by investing in an equity derivative, the State Street Stock Performance Index Futures Fund (SPIFF). Given the complexity and specialization of private equity investment, the BOI contracts with seven private equity managers. The private equity managers include Adams Street Partners (formerly Brinson Partners); Kohlberg, Kravis, Roberts and Company (KKR); Welsh Carson Anderson and Stowe; Madison Dearborn Partners; Lexington Partners; Oaktree Capital Management and Arc Light Energy Partners. Investments are presented at fair value and because no recognized market exists for private equity investment, the investments, on valuation date, are stated at the fair value reported in the most recent external managers' valuation reports. Carrying value represents the private equity security purchase price. MPEP security transactions are recorded as of trade date rather than settlement date; therefore, the MPEP portfolio at June 30 may include receivables from brokers for securities sold but not delivered, and payables to brokers for securities purchased but not received. Unit values are calculated at month end and participant transactions will most likely occur on a quarterly basis. Administrative expenses incurred by the BOI are charged daily to the MPEP based on the BOI's expenses applicable to MPEP. Based on the BOI Investment Officer's decision, participants are allowed to buy, reinvest or sell units on the first business day of each month. Private equity investments are recognized as investments with a higher degree of risk with a higher return potential. Portfolio diversification of risk is to be achieved through multiple partnership relationships and investments

diversified by time, financing stage, industry sector, investment size and geographical region. Private equity investments typically have a low correlation relative to other investment asset classes and should contribute to reduction of portfolio risk. The Montana BOI is a limited partner in the private equity partnership of O'Donnell & Masur L.P., which invested in Gardiner Communications, Inc. All partners received a Notice of Liability from the Internal Revenue Service claiming unpaid federal corporate taxes for Gardiner Communications, Inc. As a recipient of the distributions on the sale and dissolution of Gardiner Communications, Inc., the BOI faces potential liability. O'Donnell & Masur L.P. has retained legal counsel to represent all partners receiving a Notice of Liability. On September 5, 2003, legal counsel filed a petition on the Montana BOI's behalf in U.S. Tax Court to perfect the right to contest this matter. On February 9, 2004, all partners of O'Donnell & Masur L.P. were informed that the Internal Revenue Service Appeals Officer had completed his review of the Gardiner Communications, Inc. matter. The Officer concluded "no additional taxes are due from Gardiner Communications, Inc. and thus, no transferee liability to the partners of O'Donnell & Masur, L.P." MPEP does not participate in securities lending.

**All Other Investments** for the pension plans include equity index, real estate, mortgages and commercial loans. Fair values are determined, primarily, by reference to fair value prices supplied to the BOI by its custodial bank, State Street Bank and Trust. Effective May 1, 2003, all the Barclays Global Investors S&P 500 Equity Index Fund A and the Dimensional Fund Advisors U.S. Small Cap

---

Trust investments totaling \$740 million were transferred to the new MDEP. The real estate investments and residential and multifamily mortgages are valued based on a discounted cash flow. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. A mortized cost may also be referred to as book value. The Mortgages and Commercial loans receivable consist of residential mortgages and multifamily commercial loans. As of June 30, 2004 and 2003, there were no uncollectible account balances for Mortgages and Commercial loans. The sale of pool units in fiscal year 2004 from the MDEP, MPEP and RFBP resulted in a net gain to participants of \$73 million. In fiscal year 2003, the sale of pool units from the MPEP, TFBP, RFBP and MTCP generated a net gain to participants of \$41 million. Real estate investments held, in part, for the PERS include buildings at 100 North Park Avenue in Helena, MT; a newly constructed building at 2273 Boot Hill Court in Bozeman, MT; a building at 2401 Colonial Drive in Helena, MT; and property located on California Street in Helena, MT. The BOI also holds the building located at 1712 Ninth Avenue in Helena, MT for the sole benefit of the PERS.

**Securities Lending Collateral**, governed under the provisions of state statutes, authorizes the custodial bank, State Street Bank and Trust, to lend the BOI's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. This is accomplished by the BOI via a Securities Lending Authorization Agreement. During the period the securities are on loan, the BOI receives a

fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned security and maintain collateral equal to not less than 100 percent of the fair value of the loaned security. The BOI retains all rights and risks of ownership during the loan period. During fiscal years 2004 and 2003, State Street Bank and Trust loaned, on behalf of the BOI, certain securities held by State Street Bank and Trust, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit. State Street Bank and Trust does not have the ability to pledge or sell collateral securities unless the borrower defaults. The BOI did not impose any restrictions during fiscal year 2004 and 2003 on the amount of the loans that State Street Bank and Trust made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2004 and 2003. Moreover, there were no losses during fiscal years 2004 and 2003 resulting from a default of the borrowers or State Street. During fiscal years 2004 and 2003, the BOI and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the BOI's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the BOI could not determine. For MDEP as of June 30, 2004, the carrying and fair values of the underlying securities on



---

loan were \$18.8 million and \$20.3 million, respectively. The cash collateral provided for the securities on loan totaled \$20.6 million. For RFBP as of June 30, 2004, the carrying and fair values of the underlying securities on loan were \$198.6 million and \$210 million, respectively. The cash collateral provided for the securities on loan totaled \$215.7 million. For MTIP as of June 30, 2004, the carrying and fair values of the underlying securities on loan were \$33.1 million and \$41.7 million, respectively. The cash collateral provided for the securities on loan totaled \$43.8 million. For All Other Funds as of June 30, 2004, the carrying and fair values of the underlying securities on loan were \$219 million and \$222.2 million, respectively. The collateral provided for the securities on loan totaled \$226.7 million in cash and \$1.4 million in collateral.

**Fixed investments** are administered through outside vendors Pacific Investment Management Company (PIMCO) and custodial bank State Street Bank Kansas City (SSKC). The PERS-DCRP fixed money is invested in a PIMCO mutual fund. The deferred compensation fixed investment is a separately managed fund that is benchmarked against the Lehman Intermediate Government/Credit/Yankee index with a duration not to exceed four years. The minimum average portfolio quality must be an A-rating; the minimum issue quality must be a BB-rating and the minimum commercial paper quality must be A2/P2. The quality ratings applied are the higher of Moody's, Standard & Poor or Fitch. PIMCO has the discretion to invest in a broad array of public and private asset classes and investment vehicles including: money market instruments; U.S. Treasury and

Agency notes and bonds; municipal bonds; corporate securities; Yankee and Euro bonds; mortgage-backed securities; mortgage derivatives; asset-backed securities; convertible securities; non-U.S. dollar denominated securities; non-leveraged structured notes; futures; options; swaps; credit default swaps and PIMCO pooled funds. All investments including those with derivative characteristics are reported at fair value; therefore, no additional disclosures are required. PIMCO may not invest in: caps and floors; preferred stock; emerging market securities; event-linked bonds and bank loans.

**Variable investments** are held and managed by a selection of retail and institutional mutual funds, which cover all standard asset classes and categories. The selection of offered mutual funds is designed to provide plan participants with the ability to diversify and meet their individual investment goals and strategies. The PERB, with the advice of the statutorily created Employee Investment Advisory Council and the assistance of an independent contracted third-party consultant and investment analyst, conducts an annual review of the offered mutual funds. During the annual review, the PERB may decide to retain, replace or place in a watch status, any of the offered mutual funds. The goal of the annual review is to ensure the offered mutual funds meet standards established in the Investment Policy Statement adopted by the PERB. Mutual Funds are listed on pages 63 and 66 or a listing can be obtained by contacting the MPERA.

---

## B. LITIGATION

Each of the plans administered by the PERB may be involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management and legal counsel, the disposition of most of the matters will not have a material, adverse affect on any plan's financial position as a whole. The potential effect of the case discussed below has not been determined.

A lawsuit, *Baumgardner v. PER Board* (Cause No. ADV-2002-450), has been filed challenging the constitutionality of that portion of Chapter 149, laws of Montana 2001 which, in the definition of "actuarial equivalent", substituted "the mortality table and interest rate assumptions adopted by the Board" for "the 1971 Group Annuity Mortality Table, with ages set back 4 years and an interest rate of 8% compounded annually". This amendment was effective March 29, 2001. Subsequent to the legislation, effective July 1, 2001, the Public Employees' Retirement Board adopted new actuarial assumptions, including new mortality tables, resulting in new actuarial equivalent option factors. The legal challenge is the use of these new actuarial equivalent option factors in determining the actuarial equivalent benefit payout when a single life benefit is converted to an alternate form of benefit payment. The plaintiff seeks recalculation of benefit payments and attorney's fees. The action was filed by a PERS member, but could affect other systems where members have the option to choose a benefit payment other than for the member's life only.

Three constitutional claims have been

made: 1) that the legislation contained more than one subject matter, not properly reflected in the title; 2) that the legislation was an unconstitutional delegation of legislative authority; and 3) that the legislation constituted an unconstitutional impairment of contract. The district court has dismissed the first claim; found in favor of the plaintiff on the second claim; and found the third claim moot. The PERB's request for supervisory control by the Montana Supreme Court was denied. Appeal of the district court's holding on the second claim is now being pursued. Requested amendments allowing two additional claims (violation of equal protection and noncompliance with the Montana Administrative Procedure Act in the adoption of the new option factors) were not ruled on by the district court, which has implied they are moot.

An adverse decision would have different actuarial consequences depending on the claim and the breadth of the court's holding. If, as the district court has implied, the legislature cannot delegate any benefit-related actuarial function to the Board, the actuarial consequence of such a ruling would be immaterial, as all members would be required to take a single-life benefit (which all actuarial equivalent forms currently are presumed to equal). If, as the district court has held, only the new mortality table is unconstitutional, then use of the mortality table specified in statute prior to March 29, 2001 would have a minimal actuarial impact on the system.

The likelihood of prevailing on appeal regarding the second claim, delegation of legislative authority, is believed to be very probable. Accurately assessing the chances of ultimately prevailing on all

claims and possible amendments is very difficult due to the complexity of the issues presented and status of the case.

### C. DEBT OBLIGATIONS

The PERS defined contribution retirement plan has an implementation loan through the Department of Administration, with the BOI. Authorization for the INTERCAP loan was provided by the Legislature, Chapter 471, Laws of 1999. Five draws were taken in the total amount of \$1,498,000. Interest repayments began immediately following the draws. Principal repayments began August 15, 2003, the year following the DCRP implementation date. The loan was renegotiated as a single sum in fiscal year 2004 to be repaid over a period of 15 years. The interest rate is variable and changes every

February, impacting the interest due on the outstanding principal balance.

An inter-entity loan in the amount of \$114,000 was made to the PERS-DCRP from the DB Education Fund on August 18, 2003 to help cover the costs of the DCRP expenses. The term of this loan is for two years and the interest rate to be repaid to the defined benefit education fund is the same as STIP. The first repayment of \$28,500 plus interest was made in June 2004, in advance of the actual due date. The remaining principal balance of the inter-entity loan is \$85,500 and is due in August 2005.

Debt service requirements (principal & interest) for the defined contribution plan are explained in the following two charts:

Schedule of Debt Repayment				
INTERCAP Loan				
Fiscal Year Ended	Rate*	Principal	Interest	Total
2005	2.70%	\$ 10,000	\$ 37,737	\$ 47,737
2006	2.70%	10,000	37,467	47,467
2007	2.70%	20,000	37,129	57,129
2008	2.70%	30,000	36,521	66,521
2009	2.70%	40,000	35,644	75,644
2010-2018	2.70%	1,290,195	208,286	1,498,480
		<u>\$ 1,400,195</u>		<u>\$ 1,792,979</u>
* Interest rate is variable. As of June 30, 2004 the interest rate was 2.7 %				

Schedule of Debt Repayment				
Inter-Entity Loan				
Fiscal Year Ended	Rate*	Principal	Interest	Total
2006	1.10%	\$ 85,500	\$941	\$ 86,441
		<u>\$ 85,500</u>		<u>\$ 86,441</u>
*Interest rate is variable. As of June 30, 2004 the interest rate was 1.10%				

#### D. PLAN MEMBERSHIP, DESCRIPTIONS AND CONTRIBUTION INFORMATION

The plans are established and amended statutorily by the Legislature. In all defined benefit plans (except VFCA), if a member leaves covered employment before retirement, the member contributions plus accrued interest may be refunded to the member. If a member returns to service and repays the withdrawn contributions plus the

interest the contributions would have earned had they remained on deposit, membership service is fully restored.

Membership of each plan as of June 30, 2004 and June 30, 2003 is detailed in the following charts:

PERS-DBRP Membership					
	<u>2004</u>	<u>2003</u>		<u>2004</u>	<u>2003</u>
Number of participating employers	526	521			
Active plan members	28,201	28,604	Retirees and beneficiaries receiving benefits		
Terminated plan members entitled to but not yet receiving benefits or a refund			Service Retirements	14,205	13,782
Vested	2,362	2,231	Disability Retirements	336	335
Non-vested	9,132	9,070	Survivor Benefits	293	284
	<u>11,494</u>	<u>11,301</u>		<u>14,834</u>	<u>14,401</u>

JRS Membership					
	<u>2004</u>	<u>2003</u>		<u>2004</u>	<u>2003</u>
Number of participating employers	1	1			
Active plan members	50	49	Retirees and beneficiaries receiving benefits		
Terminated plan members entitled to but not yet receiving benefits or a refund			Service Retirements	48	48
Vested	4	4	Disability Retirements	-	-
Non-vested	-	-	Survivor Benefits	2	2
	<u>4</u>	<u>4</u>		<u>50</u>	<u>50</u>

---

HPORS Membership					
	<u>2004</u>	<u>2003</u>		<u>2004</u>	<u>2003</u>
Number of participating employers	1	1			
Active plan members	194	201	Retirees and beneficiaries receiving benefits		
Terminated plan members entitled to but not yet receiving benefits or a refund			Service Retirements	258	250
Vested	8	7	Disability Retirements	7	8
Non-vested	11	9	Survivor Benefits	9	9
	<u>19</u>	<u>16</u>		<u>274</u>	<u>267</u>

SRS Membership					
	<u>2004</u>	<u>2003</u>		<u>2004</u>	<u>2003</u>
Number of participating employers	56	56			
Active plan members	662	661	Retirees and beneficiaries receiving benefits		
Terminated plan members entitled to but not yet receiving benefits or a refund			Service Retirements	275	260
Vested	41	39	Disability Retirements	34	33
Non-vested	73	94	Survivor Benefits	14	13
	<u>114</u>	<u>133</u>		<u>323</u>	<u>306</u>

GWPORS Membership					
	<u>2004</u>	<u>2003</u>		<u>2004</u>	<u>2003</u>
Number of participating employers	8	8			
Active plan members	685	664	Retirees and beneficiaries receiving benefits		
Terminated plan members entitled to but not yet receiving benefits or a refund			Service Retirements	82	78
Vested	18	11	Disability Retirements	-	1
Non-vested	95	90	Survivor Benefits	3	3
	<u>113</u>	<u>101</u>		<u>85</u>	<u>82</u>

---

<b>MPORS Membership</b>				
	<u>2004</u>	<u>2003</u>		<u>2004</u> <u>2003</u>
Number of participating employers	22	22		
Active plan members	603	601	Retirees and beneficiaries receiving benefits	
Terminated plan members entitled to but not yet receiving benefits or a refund			Service Retirements	531   524
Vested	20	17	Disability Retirements	13   13
Non-vested	38	42	Survivor Benefits	27   28
	<u>58</u>	<u>59</u>		<u>571</u> <u>565</u>

<b>FURS Membership</b>				
	<u>2004</u>	<u>2003</u>		<u>2004</u> <u>2003</u>
Number of participating employers	15	16		
Active plan members	438	441	Retirees and beneficiaries receiving benefits	
Terminated plan members entitled to but not yet receiving benefits or a refund			Service Retirements	468   451
Vested	10	10	Disability Retirements	5   4
Non-vested	48	50	Survivor Benefits	25   25
	<u>58</u>	<u>60</u>		<u>498</u> <u>480</u>

<b>VFCA Membership</b>				
	<u>2004</u>	<u>2003</u>		<u>2004</u> <u>2003</u>
Active plan members	2,687	2,629	Retirees and beneficiaries receiving benefits	
Terminated plan members entitled to but not yet receiving benefits			Service Retirements	940   917
Vested	671	679	Disability Retirements	-   -
			Survivor Benefits	4   4
				<u>944</u> <u>921</u>

<b>PERS-DCRP Membership*</b>				
	<u>2004</u>	<u>2003</u>		
			<u>2004</u>	<u>2003</u>
Number of participating employers	229	189		
Active plan members	915	823	Retirees and beneficiaries receiving benefits	
Terminated plan members entitled to but not yet receiving benefits or a refund			Benefit Payments	2 -
Vested	61	24	Disability Payments	- -
Non-vested	57	19	Survivor Payments	- -
	<u>118</u>	<u>43</u>		<u>2</u> -
*implemented July 1, 2002				

<b>Deferred Compensation (457) Membership</b>				
	<u>2004</u>	<u>2003</u>		
			<u>2004</u>	<u>2003</u>
Number of participating employers	9	9	Number of participating plan members	8,069 7,750
Number of participating employers that provide contributions on members' behalf	1	1	Number of participating plan members that are actively contributing to their deferred compensation accounts	5,316 5,305

---

## ***Public Employees' Retirement System-DBRP***

**Plan Description:** The PERS-defined benefit retirement plan (DBRP) is a multiple-employer, cost-sharing plan established July 1, 1945, and governed by Title 19, chapters 2 & 3, Montana Code Annotated (MCA). This plan covers the State, local governments and certain employees of the university system and school districts.

All new hires are initially members of the PERS-DBRP. New hires have a 12-month window during which they may choose to remain in the PERS-DBRP or join the PERS-DCRP. Members may not be members of both the *defined contribution* and *defined benefit* retirement plans. The choice is irrevocable. All new hires of the universities also

have a third option to join the university system's Optional Retirement Program (ORP). For members that choose to join the PERS-DCRP or the ORP, a percentage of the employer contribution will be used to maintain the funding of the PERS-DBRP.

The PERS-DBRP provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are established by state law and can only be amended by the Legislature. Benefits are based on eligibility, years of service and highest average compensation. Member rights are vested after five years of service. A brief summary of eligibility and benefits follows:

### **PERS-DBRP Summary of Benefits**

#### **Member's highest average compensation (HAC)**

Highest average compensation during any consecutive 36 months

#### **Years of service required and/or age eligible for benefit**

Service retirement:

- 30 years, any age;
- Age 60, 5 years of service; or
- Age 65, regardless of service

Early retirement, actuarially reduced:

- Age 50, 5 years of service; or
- Any age, 25 years of service

**Vesting**     5 years

#### **Monthly benefit formula**

Less than 25 years of membership service: 1.785% of HAC per year of service credit;  
25 years of membership service or more: 2% of HAC per year of service credit

#### **Guaranteed Annual Benefit Adjustment (GABA)**

After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of other adjustments to the member's benefit



At June 30, 2004 PERS had 526 participating employers, an increase of five from FY 2003. The participating employers consist of:

<b>PERS-DBRP EMPLOYERS</b>		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies	35	34
Counties	55	55
Cities and Towns	94	93
Colleges and Universities	5	5
School Districts	237	237
High Schools	5	5
Other Agencies	<u>95</u>	<u>92</u>
Total	526	521

*Contributions:* Member and employer contribution rates are established by state law and may be amended only by the Legislature. The member contribution rate for fiscal year 2004 was 6.9% of PERS-covered payroll, the same as in fiscal year 2003. Contributions are deducted from each member's salary and remitted by participating employers. An individual account is established for each member's contributions and interest allocations until a request for retirement or refund is processed. Each state agency and university system employer contributed 6.9% of PERS-covered payroll during fiscal years 2004 and 2003. Participating local governments and school district employers contributed 6.8% of PERS-covered payroll during fiscal years 2004 and 2003. The State contributed the remaining 0.1% for local governments and school district employers from the state general fund in fiscal years 2004 and 2003. A percentage of the employers' contributions is used to fund the employee education program. (Reference Schedule of Contribution Rates on page A-59).

<b>PERS-DBRP Membership by Employer</b>		
<u>Employer Type</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies	10,528	10,757
Counties	5,470	5,504
Cities	3,012	3,020
Universities	2,561	2,499
High Schools	60	59
School Districts	5,404	5,619
Other Agencies	<u>1,166</u>	<u>1,146</u>
Total	28,201	28,604

*Plan Membership Elections:* MPERA has also included in the financial statements transfers of \$27 thousand to Transfers to DCRP and \$5 thousand to Transfers to ORP. These transfers reflect the DCRP and ORP contributions of participants that filed elections at or near the June 30th cutoff date but the contributions were moved in early fiscal year 2005.

*Additional Service Purchase:* A provision (19-2-706, MCA) related to the Employee Protection Act allows state and university system employees, who are eligible for a service retirement and whose positions have been eliminated, to have their employer

---

pay a portion of the total cost of purchasing up to three years of "1-for-5" additional service. As of fiscal year 2004, three hundred eight employees had taken advantage of this provision since its inception, up from two hundred seventy-seven in fiscal year 2003. The employer has up to ten years to complete payment for the service purchases and is charged 8% interest on the unpaid balance. The retirement incentive contributions received (including interest) during fiscal years 2004 and 2003 totaled \$419,789 and \$371,473, respectively. The outstanding balance at June 30, 2004, totaled \$215,459.

*Public Employees' Retirement System-DBRP Education Fund:* Education is provided to all members of the PERS regardless of plan choice as governed by section 19-3-112, MCA. The education must be presented with impartial and balanced information about plan choices, investments and retirement planning. The education program consists of three primary components:

- 1) initial transfer education - complete as of July 1, 2003;
- 2) ongoing transfer education - for new hire members after the July 1, 2002 plan start date; and

## ***Judges' Retirement System***

*Plan Description:* The JRS is a single-employer defined benefit plan established in 1967, and governed by Title 19, chapters 2 & 5 of the MCA. This system provides benefits for all Montana judges of the district courts, justices of the Supreme Court, and the Chief Water Judge. Benefits are established by state law and can only be amended by the Legislature. The JRS provides retirement, disability and death benefits to plan members and their

- 3) ongoing investment/retirement planning education - for all active members.

The education program was funded by 0.04% of PERS-covered payroll in fiscal year 2004 the same as fiscal year 2003.

*Actuarial Status:* The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the Normal Cost Rate plus an amortization payment of the Unfunded Actuarial Liability, if any, over no more than 30 years. Based on the current Actuarial Value of Assets and all future experience emerging as assumed, the Unfunded Actuarial Liability will not be amortized over the next 30 years. In general, the deterioration of the funded status is primarily due to recognizing prior investment losses due to returns less than the long-term assumed rate of 8% per year. Based on the actuarial assumptions as of June 30, 2004, an additional funding rate of 1.19% of payroll would be required to fund the current and projected benefits from the System in accordance with GASB standards and state law.

beneficiaries. Benefits are based on eligibility, years of service and compensation. Member rights are vested after five years of service. A brief summary of eligibility and benefits is on the following page:

## JRS Summary of Benefits

**Member's current salary<sup>1</sup> or highest average compensation (HAC)<sup>2</sup>**

<sup>1</sup>Hired prior to July 1, 1997 and non-GABA — monthly compensation at time of retirement;

<sup>2</sup>Hired after June 30, 1997 or electing GABA — HAC during any consecutive 36 months

### **Years of service required and/or age eligible for benefit**

Age 60, 5 years of service;

Any age with 5 years of service — involuntary termination, actuarially reduced

**Vesting** 5 years

### **Monthly benefit formula**

3 1/3% of current salary<sup>1</sup> (non-GABA) OR HAC<sup>2</sup> (GABA) per year of service for the first 15 years, plus 1.785% per year for each year after 15 years

### **Guaranteed Annual Benefit Adjustment (GABA)**

Hired after July 1, 1997, or those electing GABA - after the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit

### **Minimum benefit adjustment (non-GABA)**

Hired prior to July 1, 1997 - current salary is used in the calculation of the monthly benefit each time the Legislature increases salaries for active judges.

At June 30, 2004 JRS had one participating employer, the same as FY 2003. The participating employer consists of:

<b>JRS EMPLOYERS</b>		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies - Supreme Court	<u>1</u>	<u>1</u>
<b>Total</b>	<b>1</b>	<b>1</b>

**Contributions:** Member and employer contribution rates are established by state law and may be amended only by the Legislature. The member contribution rate for fiscal years 2004 and 2003 was 7.0% of the member's monthly compensation. Contributions are deducted from each member's salary and remitted by the participating employer. An individual account is established for each member's contributions and interest allocations until a retirement or refund request is processed. As

the employer, the State contributed 25.81% of the total JRS-covered payroll to the retirement plan during fiscal years 2004 and 2003. (Reference Schedule of Contribution Rates on page A-59).

<b>JRS Membership by Employee Type</b>		
<u>Employee Type</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
GABA	15	15
Non-GABA	35	34
<b>Total</b>	<b>50</b>	<b>49</b>

---

## ***Highway Patrol Officers' Retirement System***

**Plan Description:** The HPORS is a single-employer, defined benefit plan established July 1, 1971, and governed by Title 19, chapters 2 & 6 of the MCA. This system provides retirement benefits to all members of the Montana Highway Patrol, including supervisory personnel. Benefits are established by state law and can only be amended by the

Legislature. The HPORS provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service and highest average compensation. Member rights are vested after five years of service. A brief summary of eligibility and benefits follows:

### **HPORS Summary of Benefits**

#### **Member's highest average compensation (HAC)**

Highest average compensation during any consecutive 36 months

#### **Years of service required and/or age eligible for benefit**

20 years of service, regardless of age;

5 years of service, actuarially reduced from age 60

**Vesting**     5 years

#### **Monthly benefit formula**

2.5% of HAC per year of service

#### **Guaranteed Annual Benefit Adjustment (GABA)**

Hired after July 1, 1997, or those electing GABA - after the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit

#### **Minimum benefit adjustment (non-GABA)**

Hired prior to July 1, 1997 - monthly benefits for non-GABA members are increased each July when they fall below a statutorily guaranteed minimum. Any annual increase is limited to 5% over the current benefit and may not exceed 60% of the current base salary of a probationary officer.

At June 30, 2004 HPORS had one participating employer, the same as FY 2003. The participating employer consists of:

<b>HPORS EMPLOYERS</b>		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies - Dept. of Justice	<u>1</u>	<u>1</u>
Total	1	1

**Contributions:** Member and employer contribution rates are established by state law and may be amended only by the Legislature. The member contribution rates for fiscal years 2004 and 2003 are 9.05% of the member's total compensation if hired after June 30, 1997 or for members electing GABA and 9.0% for those members hired prior to July 1, 1997 and not electing GABA. Contributions are deducted from each member's salary and remitted by the participating employer. An individual account is established for each member's contributions and interest allocations until a retirement or refund request is processed. As the employer, the State contributed 36.33% of the total HPORS-covered payroll during fiscal years 2004 and 2003. The first 26.15% is payable from the same source used to pay members' compensation. The remaining amount, equal to 10.18%, is payable from a portion of the fees collected from drivers' license and duplicate drivers' license applications. (Reference Schedule of Contribution Rates on page A-59).

HPORS Membership by Employee Type		
Employee Type	June 30, 2004	June 30, 2003
GABA	194	200
Non-GABA	0	1
Total	194	201

Twenty-five cents of each motor vehicle registration fee must be deposited in the HPORS trust fund by the end of each fiscal year. This additional contribution funds the supplemental lump-sum benefit for eligible recipients.

**Additional Service Purchase:** A provision (19-2-706, MCA) related to the Employee Protection Act allows state and university system employees, who are eligible for a service retirement and whose positions have been eliminated, to have their employer

pay a portion of the total cost of purchasing up to three years of "1-for-5" additional service. The employer has up to ten years to complete payment for the service purchases and is charged 8% interest on the unpaid balance. No employees have taken advantage of this provision to date.

**Supplemental Benefit:** Montana highway patrol officers retired prior to July 1, 1991, or their survivors, may be eligible for an annual supplemental lump-sum payment distributed each September. A portion of each motor vehicle registration fee funds this supplemental benefit. Many factors must be considered for eligibility, including the number of years the recipient has received a benefit and the recipient's age. The average annual supplemental payment in September 2004 was \$2,310. In September 2003, the average annual supplemental payment was \$2,292. This enhancement is available to non-GABA recipients only.

---

## ***Sheriffs' Retirement System***

**Plan Description:** The SRS is a multiple-employer, cost-sharing defined benefit plan established July 1, 1974, and governed by Title 19, chapters 2 & 7, MCA. This plan provides retirement benefits to all Department of Justice criminal investigators hired after July 1, 1993, and to all Montana sheriffs. Benefits are established by state law and can only be

amended by the Legislature. The SRS provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service and highest average compensation. Member rights are vested after five years of service. A brief summary of eligibility and benefits follows:

### **SRS Summary of Benefits**

#### **Member's highest average compensation (HAC)**

Highest average compensation during any consecutive 36 months

#### **Years of service required and/or age eligible for benefit**

20 years, regardless of age;

Age 50, 5 years of service, actuarially reduced

**Vesting**     5 years

#### **Monthly benefit formula**

2.5% of HAC per year of service

#### **Guaranteed Annual Benefit Adjustment (GABA)**

After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit

At June 30, 2004 SRS had 56 participating employers, the same as FY 2003. The participating employers consist of:

<b>SRS EMPLOYERS</b>		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies - Dept. of Justice	1	1
Counties	<u>55</u>	<u>55</u>
Total	56	56

**Contributions:** Member and employer contribution rates are established by state law and may be amended only by the Legislature. The member contribution rate for fiscal years 2004 and 2003 was 9.245%. Contributions

are deducted from each member's salary and remitted by participating employers. An individual account is established for each member's contributions and interest allocations until a retirement or refund request is proc-

essed. Each employer contributed 9.535% of total SRS-covered payroll to the retirement plan during fiscal years 2004 and 2003. (Reference Schedule of Contribution Rates on page A-59).

SRS Membership by Employer Type		
Employer Type	June 30, 2004	June 30, 2003
Dept of Justice	37	34
Counties	625	627
Total	662	661

**Additional Service Purchase:** A provision (19-2-706, MCA) related to the Employee Protection Act allows state employees, who are eligible for a service retirement and whose positions have been eliminated, to have their employer pay a portion of the total cost of purchasing up to three years of "1-for-5" additional service. The employer has up to ten years to complete payment for the service purchases and is charged 8% interest on the unpaid balance. In fiscal year 2004, three employees took advantage of this provision since it's inception, the same as in fiscal year 2003. The retirement incentive contributions received (including interest) during fiscal years 2004 and 2003 totaled \$4,180 and \$33,000, respectively. The outstanding balance at June 30, 2004, totaled \$0.

**Actuarial Status:** The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the Normal Cost Rate plus an amortization payment of the Unfunded Actuarial Liability, if any, over no more than 30 years. Based on the current Actuarial Value of Assets and all future experience emerging as assumed, the Unfunded Actuarial Liability will not be amortized over the next 30 years. In general, the deterioration of the funded status is primarily due to recognizing prior investment losses due to returns less than the long-term assumed rate of 8% per year. Based on the actuarial assumptions as of June 30, 2004, an additional funding rate of 2.15% of payroll would be sufficient to fund the current and projected benefits from the System in accordance with GASB standards and state law.

## ***Game Wardens' and Peace Officers' Retirement System***

**Plan Description:** The GWPORS is a multiple-employer, cost-sharing defined benefit plan established in 1963 and is governed by Title 19, chapters 2 & 8, MCA. This system provides retirement benefits to all persons employed as a game warden, warden supervisory personnel, or state peace officer. Benefits are established by state law and can only be amended by the Legislature. The

GWPORS provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service and highest average compensation. Member rights are vested after five years of service. A brief summary of eligibility and benefits is on the following page:

---

## **GWPORS Summary of Benefits**

### **Member's highest average compensation (HAC)**

Highest average compensation during any consecutive 36 months

### **Years of service required and/or age eligible for benefit**

Age 50, 20 years of service;

Age 55, 5 years of service

**Vesting**     5 years

### **Monthly benefit formula**

2.5% of HAC per year of service

### **Guaranteed Annual Benefit Adjustment (GABA)**

After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit

At June 30, 2004 GWPORS had eight participating employers, the same as FY 2003. The participating employers consist of:

<b>GWPORS EMPLOYERS</b>		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies	5	5
Colleges and Universities	<u>3</u>	<u>3</u>
Total	8	8

**Contributions:** Member and employer contribution rates are established by state law and may be amended only by the Legislature. The member contribution rate for fiscal years 2004 and 2003 was 10.56%. Contributions are deducted from each member's salary and remitted by participating employers. An individual account is established for each member's contributions and interest allocations until a retirement or refund request is processed. Each state agency and university employer contributed 9.0% of total GWPORS-covered payroll to the retirement plan during fiscal years 2004 and 2003. (Reference Schedule of Contribution Rates on page A-59).

<b>GWPORS Membership by Employer</b>		
<u>Employer</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Dept of Corrections	471	464
Dept FW&P	94	89
Dept of Justice	6	4
Dept of Livestock	30	28
Dept of Trans.	58	54
Universities	<u>26</u>	<u>25</u>
Total	685	664

**Additional Service Purchase:** A provision (19-2-706, MCA) related to the Employee Protection Act allows state and university system employees, who are eligible for a service retirement and whose positions have been eliminated, to have their employer



---

pay a portion of the total cost of purchasing up to three years of "1-for-5" additional service. The employer has up to ten years to complete payment for the service purchases and is charged 8% interest on the unpaid balance. No employees have taken advantage of this provision to date.

*Actuarial Status:* The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the Normal Cost Rate plus an amortization payment of the Unfunded Actuarial Liability, if any, over no more than 30 years. Based on the current Actuarial Value of Assets and all future experience emerging as assumed, the

Unfunded Actuarial Liability will not be amortized over the next 30 years. In general, the deterioration of the funded status is primarily due to recognizing prior investment losses due to returns less than the long-term assumed rate of 8% per year. Based on the actuarial assumptions as of June 30, 2004, an additional funding rate of 0.23% of payroll is required to fund the current and projected benefits from the System in accordance with GA SB standards and state law.

## ***Municipal Police Officers' Retirement System***

*Plan Description:* The MPORS is a multiple employer, cost-sharing defined benefit retirement plan established in 1974 and is governed by Title 19, chapters 2 & 9 of the MCA. This plan covers all municipal police officers employed by first- and second-class cities and other cities that adopt the plan. Benefits are established by state law and can only be amended by the Legislature. The MPORS provides retirement, disability and

death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service and compensation. Member rights for death and disability are vested immediately. All other rights are vested after five years of service. A brief summary of eligibility and benefits follows:

### **MPORS Summary of Benefits**

#### **Member's final average compensation (FAC)**

Hired prior to July 1, 1977 - average monthly compensation of final year of service;

Hired after June 30, 1977 - average monthly compensation for last consecutive 36 months

#### **Years of service required and/or age eligible for benefit**

20 years, regardless of age;

Age 50, 5 years of service

**Vesting**     5 years

#### **Monthly benefit formula**

2.5% of FAC per year of service

---

**Guaranteed Annual Benefit Adjustment (GABA)**

After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit

**Minimum benefit adjustment (non-GABA)**

If hired before July 1, 1997 and member did not elect GABA, the monthly retirement, disability or survivor's benefit may not be less than  $\frac{1}{2}$  the compensation of a newly confirmed officer in the city that the member was last employed.

At June 30, 2004 MPORS had 22 participating employers, the same as in FY 2003. The participating employers consist of:

MPORS EMPLOYERS		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Cities and Towns	<u>22</u>	<u>22</u>
Total	22	22

**Contributions:** Member and employer contribution rates are established by state law and may be amended only by the Legislature. Member contribution rates are dependent upon date of hire as a police officer. For fiscal years 2004 and 2003, member contributions as a percentage of salary were 5.8% (if employed on or before June 30, 1975); 7.0% (if employed after June 30, 1975 and prior to July 1, 1979); 8.5% (if employed after June 30, 1979 and prior to July 1, 1997); and, 9.0% (if employed on or after July 1, 1997 and for members electing GABA). Contributions are deducted from each member's salary and remitted by participating employers. An individual account is established for each member's contributions and interest allocations until a retirement or refund request is processed. Employer contributions to the retirement plan are 14.41% of total MPORS-covered payroll. The State contributions are requested at the beginning of the fiscal year based on the previous fiscal year compensation and are due no later than November 1. The State's contribution rate for 2004 and

2003 was 29.37%. (Reference Schedule of Contribution Rates on page A-59).

MPORS Membership by Employee Type		
<u>Employee Type</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
GABA	591	589
Non-GABA	<u>12</u>	<u>12</u>
Total	603	601

**Deferred Retirement Option Plan (DROP):** Beginning July 2002, eligible members of MPORS can participate in the DROP by filing a one-time irrevocable election with the PERB. The DROP is governed by Title 19, chapter 9, part 12, MCA. An eligible member must have completed at least twenty years of membership service. They may elect to participate in the DROP for a minimum of one month and a maximum of five years and may participate in the DROP only once. A participant remains a member of the MPORS, but will not receive membership service or service credit in the system for the duration of the member's DROP period. Dur-

ing the participation in the DROP, all mandatory contributions continue to the retirement system. A monthly benefit is calculated based on salary and years of service to the date of the beginning of the DROP period. The monthly benefit is paid into the DROP account until the end of the DROP participation period. At the end of the DROP period, the participant may receive the balance of the DROP account in a lump-sum payment or in a direct rollover to another eligible plan, as allowed by the IRS. If the participant continues employment after the DROP period ends they will again accrue membership service and service credit. The DROP account cannot be distributed until employment is formally terminated. As of June 30, 2004, 33 members have participated in the DROP.

<b>DROP Participation</b>		
	6/30/2004	6/30/2003
Participants Beginning of Year	27	0
Participants Added	6	27
Completed DROP	2	0
Participants End of Year	31	27
DROP Distributions	\$17,663	\$ 0

## ***Firefighters' Unified Retirement System***

**Plan Description:** The FURS is a multiple-employer, cost-sharing defined benefit plan established in 1981, and governed by Title 19, chapters 2 & 13, MCA. This system provides retirement benefits to firefighters employed by first- and second-class cities and other cities that adopt the plan and to firefighters hired by the Montana Air National Guard on or after October 1, 2001. Benefits are established by state law and can only be amended by the Legislature. The FURS pro-

vides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service and compensation. Member rights are vested after five years of service. A brief summary of eligibility and benefits follows:

### **FURS Summary of Benefits**

#### **Member's compensation**

Hired prior to July 1, 1981 and not electing GABA - final monthly compensation (FMC);

Hired after June 30, 1981 and those electing GABA - final average compensation (FAC) for last consecutive 36 months

#### **Years of service required and/or age eligible for benefit**

20 years, regardless of age;

Age 50, 5 years of service

**Vesting**     5 years

**Monthly benefit formula**

Members hired prior to July 1, 1981 and not electing GABA are entitled to the greater of:  
2.5% of FAC per year of service, OR

i) if less than 20 years of service,

2% of FMC for each year of service

ii) if more than 20 years of service,

50% of the member's FMC plus 2% of the member's FMC for each year of service over 20 years

Members hired after June 30, 1981 and those electing GABA:

2.5% of FAC per year of service

**Guaranteed Annual Benefit Adjustment (GABA)**

After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit

**Minimum benefit adjustment (non-GABA)**

If hired before July 1, 1997 and member did not elect GABA, the monthly retirement, disability or survivor's benefit may not be less than  $\frac{1}{2}$  the compensation of a newly confirmed firefighter employed by the city that last employed the member (provided the member has at least ten years of service credit).

At June 30, 2004 FURS had 15 participating employers, one less than FY 2003. The participating employers consist of:

FURS EMPLOYERS		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies - Dept. of Military Affairs	1	1
Cities and Towns	<u>14</u>	<u>15</u>
Total	15	16

**Contributions:** Member and employer contribution rates are established by state law and may be amended only by the Legislature. The member contribution rates for fiscal years 2004 and 2003 are 9.5% for members hired prior to July 1, 1997, and 10.7% for members hired after June 30, 1997 and members electing GABA coverage. Contributions are deducted from each member's salary and remitted by participating employers. An individual account is established for each member's contributions and interest allocations until a retirement or refund request is processed. Employer contribution rates for fiscal years 2004 and 2003 were 14.36% of the total

FURS-covered payroll. The State contribution was 32.61% of total compensation for all covered firefighters in fiscal years 2004 and 2003. State contributions are requested at the beginning of each fiscal year based on previous fiscal year salary and are due no later than November 1. (Reference Schedule of Contribution Rates on page A-59).

FURS Membership by Employee Type		
<u>Employee Type</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
GABA	429	432
Non-GABA	<u>9</u>	<u>9</u>
Total	438	441

---

## ***Volunteer Firefighters' Compensation Act***

**Plan Description:** The VFCA is a state-wide retirement and disability plan. This compensation plan was established in 1965 and is governed by Title 19, chapters 2 & 17, MCA. All members are unpaid volunteers and the State of Montana is the only contributor to the plan. Benefits are established by state law and can only be amended by the Legislature. The VFCA provides pension, disability and survivorship benefits for all volunteer firefighters who are members of qualified volunteer fire companies in unincorporated areas, towns or villages under the laws of the State of Montana. Benefits are based on eligibility and years of service.

Member rights are vested after ten years of credited membership service. VFCA also provides limited benefits for injuries incurred in the line of duty.

Members of the VFCA can accumulate more than 20 years of service if they meet the required criteria. On or after July 1, 2003, when the member is both age 55 and already has 20 years of service, the member can accumulate years of service beyond 20 with a maximum of 30 years allowed if the member continues service. A brief summary of eligibility and benefits follows:

### **VFCA Summary of Benefits**

#### **Years of service required and/or age eligible for benefit**

Age 55, 20 years of credited service (full benefit);

Age 60, 10 years of service (partial benefit)

#### **Additional Retirement**

After July 1, 2003, active volunteers that are both age 55 and have at least 20 years of service may receive credit for additional years of service.

**Vesting**     10 years

#### **Monthly benefit formula**

\$7.50 per year of credited service, maximum \$150

If greater than 20 years of service (but not more than 30 years), maximum \$225

**Contributions:** The State is the only contributor to the VFCA. Contributions are 5% of fire insurance premium taxes collected on certain fire risks. The State Auditor makes annual payments from the general fund to the Volunteer Firefighters' Pension Fund from fire insurance premiums. (Reference Schedule of Contribution Rates on page A-59).

teer fire companies that provide additional group medical insurance for their members in case of death or injury incurred while in the line of duty. The payment is made to the volunteer fire companies and is equal to \$75 per year for each mobile firefighting unit owned by the volunteer fire company, up to a maximum of two units.

**Group Insurance Payments:** Supplemental payments are available to qualified volun-

---

## ***Public Employees' Retirement System-DCRP***

*Plan Description:* The defined contribution retirement plan (DCRP) is a multiple employer plan established July 1, 2002 and governed by Title 19, chapters 2 & 3, MCA. This plan covers eligible employees of the State, university system, local government and certain employees of the school districts that elect the defined contribution retirement plan. All new hires, initially, are members of the PERS-DBRP. New hires have a 12-month window during which they may choose to transfer to the PERS-DCRP or remain in the PERS-DBRP. The choice is irrevocable. Members may not be members of both the *defined contribution* and *defined benefit* retirement plans. The PERS-DCRP provides retirement, disability and death benefits to plan members and their beneficiaries. Contribution rates can only be amended by the Legislature. Benefits are based on eligibility and account balance.

The PERB has received a long-term INTERCAP loan from the Montana Board of Investments through the Montana Department of Administration to fund the plan start-up/implementation costs. Authorization for the loan was provided by the Legislature, Chapter 471, Laws of 1999. As of June 30, 2004, all of the draws have been combined into one loan and the maturity date extended to February 2018. The loan is discussed in Note C of the Financial Section.

The investment options offered within the PERS-DCRP are selected by the PERB with the assistance of the statutorily created Employee Investment Advisory Council (EIAC) and with the advice of a third-party investment analyst. Members of the DCRP decide how to invest their contributions and a portion of their employer's contributions among

the offered investment options. The remaining portion of employer's contributions is used to maintain funding of the defined benefit plan, to provide disability benefits and to fund an employee education program. Members are able to invest in any number of the offered investment options and transfer between options, daily, if desired. The variable investment options cover all standard asset classes and categories and range from aggressive to conservative. The investment options as of June 30, 2004 are as follows:

### PERS-DCRP Investment Options

#### ***International Stock Funds***

American Funds New Perspective  
SSGA International Growth Opportunities  
Oakmark International

#### ***Small Company Stock Funds***

Brown Capital Small Co Instl  
Vanguard Small Cap Index Adm  
Hotchkis & Wiley Small Cap Value

#### ***Mid-Sized Company Stock Funds***

Artisan Mid Cap  
Janus Mid Cap Value Investors

#### ***Large Company Stock Funds***

American Funds Growth Fund A  
Vanguard Equity-Income Adm  
Vanguard Growth & Income Adm

#### ***Balanced Funds***

Vanguard Balanced Index

#### ***Bond Funds***

Vanguard Total Bond Market Index

#### ***Fixed Investment Options***

DCRP Fixed Fund

---

Mutual fund administrative costs are not presented on the financial statements. Mutual fund earnings are generally declared net of expenses in accordance with the Securities Exchange Commission and other regulatory authorities. Current reporting standards for mutual companies do not require costs to be made available in the detailed cost reports.

The fixed investment option requires the services of three external providers who were selected through the State's competitive bidding process. The external providers are: Aegon, Pacific Investment Management Company (PIMCO) and State Street Bank Kansas City (SSKC). Aegon provides a guarantee of principal and sets a quarterly rate of return based upon the investment manager's portfolio yield and duration. PIMCO, the investment manager, directs the investment of fixed assets. Fixed assets are invested in the mutual market in accordance with established guidelines for credit quality, duration and issue concentration. SSKC is PIMCO's custodial bank and holder of the fixed assets. SSKC exchanges the assets as directed by PIMCO.

Fees on the fixed investments are charged by each of the three providers. The fees are defined per each contract for specific services rendered. The record keeper, Great West,

charges a fixed administrative fee for all plan participants plus a basis point (or percent) fee based on account balances. On a quarterly basis, the contracted record keeper withholds the fees from each plan participant's account. The basis point fees withheld are submitted to the PERB to pay administrative expenses. These amounts are recorded as *Miscellaneous Revenue* in the financial statements.

Administrative expenses and the revenues that fund them are accounted for within the plan. For the PERS-DCRP, the fixed investment is invested in a PIMCO mutual fund and all fees for investment expense are netted from the mutual fund earnings; therefore, the fees are not presented on our financial statements. The fees charged by Great West and Aegon are classified as *Miscellaneous Expense*.

A brief summary of eligibility and benefits follows:

### **PERS-DCRP Summary of Benefits**

#### **Eligibility for Benefit**

Termination of service

#### **Vesting**

Immediate for member's contributions and attributable income;

5 years for employer's contributions and attributable income

#### **Benefit**

Dependent upon individual account balance;

IRS permitted rollovers are also possible

At June 30, 2004 PERS-DCRP had 229 reporting employers, an increase of 40 from FY 2003. The participating employers consist of:

PERS-DCRP EMPLOYERS		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies	28	25
Counties	44	42
Cities and Towns	37	29
Universities	5	4
School Districts	88	68
Other Agencies	<u>27</u>	<u>21</u>
Total	229	189

*Contributions:* Member and employer contribution rates are established by state law and may be amended only by the Legislature. The member contribution rate for fiscal year 2004 is 6.9% of member's compensation. Contributions are deducted from each member's salary and remitted by participating employers. The entire amount of the member's contribution is credited to the member's retirement account. An individual account is maintained by the third-party record keeper. Each state agency and university system employer contributes 6.9% of PERS-covered payroll beginning with fiscal year 2003. Participating local governments and school district employers contribute 6.8% of PERS-covered payroll. The State contributes the remaining 0.1% for local governments and school employers from the state general fund. The employer rate of 6.9% is allocated as follows: 4.19% allocated to the member's retirement account, 2.37% allocated to the defined benefit plan choice rate, 0.04% allocated to defined contribution education fund and 0.3% allocated to the long-term disability plan. (Reference Schedule of Contribution Rates on page A-59).

PERS-DCRP Membership by Employer		
<u>Employer Type</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State Agencies	345	331
Counties	193	167
Cities	130	114
Universities	39	29
High Schools	1	0
School Districts	144	123
Other Agencies	63	59
Total	<u>915</u>	<u>823</u>

*Plan Membership Elections:* Included in the financial statements are employer contribution transfers of \$10 thousand and member contribution transfers of \$17 thousand. These transfers reflect the contribution transfers of DCRP participants that filed elections at or near the June 30th cutoff date but the contributions were moved in early fiscal year 2005.

*DCRP Education Fund:* Implemented July 1, 2002, the DCRP Education Fund (DCEd), as governed by section 19-3-112, MCA, provides education to the members that have joined the PERS-DCRP and the



---

ORP. The DCEd is funded by 0.04% of the employers' contribution.

*DCRP Disability Fund:* Implemented July 1, 2002, the DCRP Disability Fund (DC Disability), as governed by section 19-3-2117,

MCA, will provide disability benefits to eligible members of the PERS-DCRP. The DC Disability is funded by 0.3% of the employers' contribution.

## ***Deferred Compensation Plan (457)***

***Plan Description:*** The deferred compensation (457) plan is a voluntary supplemental retirement savings plan established in 1976. The deferred compensation plan is governed by Title 19, chapter 50, MCA, in accordance with Internal Revenue Service Code (IRC) §457. All employees of the State, the Montana University System and contracting political subdivisions, are eligible to participate.

Assets of the deferred compensation plan are required to be held in trusts, custodial accounts or insurance company contracts for the exclusive benefit of participants and their beneficiaries. Great West is the third-party record keeper for the deferred compensation plan. Participants elect to defer a portion of their salary, within Internal Revenue Code limits. The deferred salary is not available to employees until separation from service, retirement, death, or upon an unforeseeable emergency while still employed and must meet IRC-specified criteria.

Plan participants direct their deferred salary into investment options offered within the plan. The investment options offered are selected by the PERB with the assistance of the statutorily-created Employee Investment Advisory Council (EIAC) and with the advice of a third-party investment analyst. Plan participants may invest in as many of the offered investment options as desired. The offered investment options fall into two primary types: (1) the fixed investment option and (2)

the variable investment options. The investment options as of June 30, 2004 are as follows:

### **Deferred Compensation (457) Plan** **Investment Options**

#### ***International Stock Funds***

Artisan International  
Janus Worldwide  
Mutual Discovery Z  
Templeton Foreign A

#### ***Small Company Stock Funds***

Neuberger Berman Genesis  
RS Diversified Growth

#### ***Mid-Sized Company Stock Funds***

Artisan Mid Cap Investors  
Strong Opportunity Inv

#### ***Large Company Stock Funds***

Davis NY Venture A  
Fidelity Contrafund  
TCW Galileo Select Equities N  
Vanguard 500 Index  
Calvert Social Investors

#### ***Balanced Funds***

Dodge & Cox Balanced  
Janus Balanced

#### ***Bond Funds***

Columbia High-Yield  
PIMCO Total Return Admin

---

***Fixed Investment Options***  
**Montana Fixed Fund**

***Profile Funds***  
Aggressive  
Moderately Aggressive  
Moderate  
Moderately Conservative  
Conservative

The variable investment options include mutual funds and profile funds. All options range from aggressive to conservative. The mutual funds cover all standard asset classes and categories. The profile funds are preset funds that invest in underlying mutual funds to achieve a set objective such as time horizon or investment style.

Mutual fund administrative costs are not presented on the financial statements. Mutual fund earnings are generally declared net of expenses in accordance with the Securities Exchange Commission and other regulatory authorities. Current reporting standards for mutual companies do not require costs to be made available in the detailed cost reports.

The fixed investment option guarantees both principal (the deferred salary) and a quarterly rate of return. The fixed investment option requires the services of three external providers who were selected through the State's competitive bidding process. The external providers are: Aegon, Pacific Investment Management Company (PIMCO) and State Street Bank Kansas City (SSKC). Aegon provides a guarantee of principal and sets a quarterly rate of return based upon the investment manager's portfolio yield and duration. PIMCO, the investment manager, directs the investment of fixed assets. Fixed assets are invested in the bond market in accordance with established guidelines for credit quality, duration and issue concentration. SSKC is

PIMCO's custodial bank and holder of the fixed assets. SSKC exchanges the assets as directed by PIMCO.

In addition to the above investment options, plan participants previously had the option to direct a portion of their deferrals to a term life insurance policy provided through Allianz Life Insurance. The ability to invest in life insurance is allowed under the IRC and was offered to plan participants prior to life insurance being offered as a standard component of health insurance benefit packages. This investment option has been discontinued; however, plan participants who had previously or originally elected this option may continue.

Fees on the fixed investments are charged by each of the three providers. The fees are defined per each contract for specific services rendered. The record keeper, Great West, charges a fixed administrative fee for all plan participants. The fixed record-keeping fee, by contract, is a flat dollar amount. On a quarterly basis, the contracted record keeper withholds the basis point fee from each plan participant's account. The basis point fees collected are reconciled to the contractual flat dollar amount and any fees withheld in excess of the contractual flat dollar fee are submitted to the PERB. Also submitted to the PERB are 12(b)(1) or re-allotment fees from certain mutual fund companies. These fees are normally charged by the mutual funds for the purpose of individual record keeping. Because the mutual fund companies involved in the deferred compensation plan do not need to keep records of participants accounts, the fees are returned to the PERB. The PERB uses the excess and 12(b)(1) fees to pay administrative expenses associated with the deferred compensation plan. These amounts are recorded as *Miscellaneous Revenue*.

Administrative expenses and the revenues that fund them are accounted for within the plan. The fees charged by PIMCO and SSKC for the externally managed fixed investments are classified as *Investment Expense*. The fees charged by Great West and Aegon are classified as *Miscellaneous Expense*.

A brief summary of eligibility and benefits follows:

### **Deferred Compensation Plan Summary**

#### **Contribution**

Voluntary, tax-deferred

#### **Eligibility for Benefit**

Not available to participant until separation from service; retirement; death; or upon an unforeseeable emergency, while still employed, provided IRS-specified criteria are met

#### **Vesting**

Participants are fully vested in their accounts at the time of deposit

#### **Benefit**

Lump sum or periodic benefit payment, at the option of the participant. Based on individual account balances and plan provisions. IRS permitted rollovers are also possible.

At June 30, 2004 the deferred compensation plan had nine participating employers, the same as FY 2003. The participating employers consist of:

<b>DEFERRED COMPENSATION EMPLOYERS</b>		
<u>Employers</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
State of Montana *	1	1
Colleges and Universities	6	6
Other	<u>2</u>	<u>2</u>
Total	9	9
*The State of Montana includes 35 agencies; however, due to the nature of the reporting for the 457 plan we are unable to specifically determine which agencies participate.		

---

*Contributions:* The deferred compensation plan is a voluntary, tax-deferred retirement plan designed to supplement retirement, Social Security and other retirement plans and savings. Participants designate the amount to contribute within IRC limitations. The deferred salary is withheld through payroll deduction prior to federal and state taxes. Social Security and Medicare taxes are withheld on the deferred salary. The contributions are either directed to the fixed investment or

to any number of the available variable investments. The money designated as fixed is invested by PIMCO. The money designated as variable is remitted to the third-party record keeper who in turn invests the contributions in selected investments as directed by the participant.

---

This page intentionally left blank

## FY 2004 Schedule of Contribution Rates

System	Member	Employer	State
<b>PERS-DBRP</b>	6.9% [19-3-315, MCA]	6.9% State & University 6.8% Local Governments [19-3-316, MCA]	0.1% of local government payroll - paid from the General Fund [19-3-319, MCA]
<b>PERS-DCRP</b>	6.9% [19-3-315, MCA]	6.9% State & University 6.8% Local Governments [19-3-316, MCA]	0.1% of local government payroll - paid from the General Fund [19-3-319, MCA]
<b>JRS</b>	7.0% [19-5-402, MCA]	25.81% [19-5-404, MCA]	
<b>HPORS</b>	9.0% - hired prior to 7-01-97 & not electing GABA 9.05% - hired after 6-30-97 & members electing GABA [19-6-402, MCA]	26.15% [19-6-404(1), MCA] 10.18% of salaries - paid from drivers' license fees [19-6-404(2), MCA]	
<b>SRS</b>	9.245% [19-7-403, MCA]	9.535% [19-7-404, MCA]	
<b>GWPORS</b>	10.56% [19-8-502, MCA]	9.0% [19-8-504, MCA]	
<b>MPORS</b>	5.8% - hired on or before 6-30-75 & not electing GABA [19-9-710(a), MCA] 7.0% - hired after 6-30-75 & prior to 7-1-79 & not electing GABA [19-9-710(b), MCA] 8.5% - hired after 6-30-79 and prior to 7-1-97 & not electing GABA [19-9-710(c), MCA] 9.0% - hired after 6-30-97 & members electing GABA [19-9-710(d), MCA]	14.41% [19-9-703, MCA]	29.37% of salaries - paid from the General Fund [19-9-702, MCA]
<b>FURS</b>	9.5% - hired prior to 7-01-97 & not electing GABA [19-13-601(2)(a), MCA] 10.7% - hired after 06-30-97 & members electing GABA [19-13-601(2)(b), MCA]	14.36% [19-13-605, MCA]	32.61% of salaries - paid from the General Fund [19-13-604, MCA]
<b>VFCA</b>			5.0% of fire insurance premiums, paid from the General Fund [19-17-301, MCA]

# Public Employees' Retirement Board

*A Component Unit of the State of Montana*

## Required Supplementary Information

### Schedule of Funding Progress

(in thousands)

System	Actuarial Valuation Date	Actuarial Value of Assets <sup>1</sup> (a)	Actuarial Accrued Liability (AAL) -Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll ( c )	UAAL as a Percentage of Covered Payroll ((b-a)/c)
PERS-DBRP	06/30/00	2,843,347	2,273,407	(569,940)	125.07%	725,692	-78.54%
	06/30/02	3,076,781	3,077,764	983	99.97	808,747	0.12%
	06/30/04	3,047,287	3,514,085	466,798	86.72	832,847	56.05%
JRS	06/30/00	42,043	27,365	(14,678)	153.64	3,483	-421.42%
	06/30/02	44,963	30,882	(14,081)	145.60	4,000	-352.03%
	06/30/04	45,134	34,724	(10,410)	129.98	4,403	-236.43%
HPORS	06/30/00	77,810	76,397	(1,413)	101.85	6,952	-20.33%
	06/30/02	81,734	94,850	13,116	86.17	7,536	174.04%
	06/30/04	79,104	104,069	24,965	76.01	7,844	318.27%
SR5	06/30/00	126,338	87,836	(38,502)	143.83	21,559	-178.59%
	06/30/02	138,590	121,625	(16,965)	113.95	24,521	-69.19%
	06/30/04	141,022	148,608	7,586	94.90	27,373	27.71%

Analysis of the dollar amounts of plan net assets, actuarial accrued liability, and unfunded actuarial accrued liability provides one indication of the plan's funding status on a going-concern basis. Analysis of this percentage percentage, the stronger the plan. Trends in the unfunded actuarial accrued liability and annual covered covered payroll approximately adjusts for the effects of inflation and aids analysis of the plan's progress stronger the plan.

<sup>1</sup>Refer to the "Notes to the Required Supplementary Information" for the Actuarial Asset Valuation Method (Page A-64).

---

System	Actuarial Valuation Date	Actuarial Value of Assets <sup>1</sup> (a)	Actuarial Accrued Liability (AAL) -Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll ( c )	UAAL as a Percentage of Covered Payroll ((b-a)/c)
<b>GWPORS</b>	06/30/00	32,966	23,922	(9,044)	137.81%	11,875	-76.16%
	06/30/02	38,730	39,109	379	99.03	17,151	2.21%
	06/30/04	45,210	50,310	5,100	89.86	21,442	23.79%
<b>MPORS</b>	06/30/00	129,826	181,109	51,283	71.68	20,252	253.22%
	06/30/02	143,516	226,827	83,311	63.27	22,229	374.79%
	06/30/04	149,510	260,094	110,584	57.48	24,531	450.79%
<b>FURS</b>	06/30/00	123,492	162,329	38,837	76.08	16,549	234.68%
	06/30/02	136,392	197,946	61,554	68.90	17,953	342.86%
	06/30/04	142,109	227,599	85,490	62.44	20,248	422.21%
<b>VFCA</b>	06/30/00	17,769	16,752	(1,017)	106.07	N/A	N/A
	06/30/02	19,254	26,808	7,554	71.82	N/A	N/A
	06/30/04	20,058	28,680	8,622	69.94	N/A	N/A

Covered payroll is not applicable to VFCA because members are unpaid volunteers.

liability in isolation can be misleading. Expressing plan net assets as a percentage of the actuarial accrued liability over time indicates whether the plan is becoming financially stronger or weaker. Generally, the greater this payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability as a percentage of annual made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the



---

## Public Employees' Retirement Board

*A Component Unit of the State of Montana*

### Required Supplementary Information

#### Schedule of Employer Contributions & Other Contributing Entities

System	Year Ended June 30	Annual Required Contribution	Percentage Contributed	Annual Required State Contribution	Percentage Contributed	Annual Required Registration Fees	Percentage Contributed
PERS- OBRP	1999	\$ 46,783,993	101.62%	\$ 341,099	100.00%		
	2000	49,347,082	98.74%	347,560	100.00%		
	2001	52,460,464	101.43%	382,481	100.00%		
	2002	54,994,798	101.01%	373,721	100.00%		
	2003	57,724,802	99.13%	388,954	100.00%		
	2004	56,633,623	102.04%	402,566	100.00%		
JRS	1999	822,795	100.00%				
	2000	899,056	100.00%				
	2001	943,532	100.00%				
	2002	1,032,319	100.00%				
	2003	1,052,361	100.00%				
	2004	1,136,526	100.00%				
HPORS <sup>1</sup>	1999	2,293,662	100.65%			285,095	100.00%
	2000	2,525,631	101.26%			279,577	100.00%
	2001	2,670,900	98.91%			335,107	100.00%
	2002	2,737,999	101.16%			308,973	100.00%
	2003	2,836,992	101.02%			353,589	100.00%
	2004	2,849,545	100.32%			348,137	100.00%
SRS	1999	1,994,769	104.36%				
	2000	2,055,688	106.84%				
	2001	2,159,464	103.14%				
	2002	2,338,104	102.10%				
	2003	2,435,269	101.65%				
	2004	2,609,975	103.64%				

---

Refer to the "Notes to the Required Supplementary Information" (Page A-64).

<sup>1</sup> A change was made for HPORS to correct contributions erroneously reported in FY 1999 that should have been FY 1998.

<sup>2</sup> The Annual Required Contribution for MPORS and FURS is based on covered payroll, which includes payroll adjustments.

---

System	Year Ended June 30	Annual Required Contribution	Percentage Contributed	Annual Required State Contribution <sup>2</sup>	Percentage Contributed	Annual Required Registration Fees	Percentage Contributed
<b>GWPORS</b>	1999	\$ 891,602	104.42%				
	2000	1,068,745	102.92%				
	2001	1,339,308	101.98%				
	2002	1,543,547	103.33%				
	2003	1,803,149	101.77%				
	<b>2004</b>	<b>1,929,800</b>	<b>104.73%</b>				
<b>MPORS</b>	1999	2,731,079	99.01%	\$ 5,566,398	100.18%		
	2000	2,918,274	100.57%	5,947,932	99.35%		
	2001	3,011,475	100.12%	6,137,893	100.16%		
	2002	3,203,173	102.15%	6,528,604	100.02%		
	2003	3,355,991	104.35%	6,840,073	99.39%		
	<b>2004</b>	<b>3,534,920</b>	<b>102.68%</b>	<b>7,204,760</b>	<b>100.05%</b>		
<b>FUR5</b>	1999	2,262,645	100.94%	5,138,222	98.77%		
	2000	2,376,392	97.86%	5,396,528	97.80%		
	2001	2,401,328	98.81%	5,453,155	98.45%		
	2002	2,578,021	97.80%	5,854,406	98.46%		
	2003	2,672,133	104.87%	6,068,123	98.98%		
	<b>2004</b>	<b>2,876,584</b>	<b>100.09%</b>	<b>6,532,410</b>	<b>100.00%</b>		
<b>VFCA</b>	1999			944,434	100.00%		
	2000			961,306	100.00%		
	2001			1,002,992	100.00%		
	2002			1,133,741	100.00%		
	2003			1,310,088	100.00%		
	<b>2004</b>			<b>1,434,068</b>	<b>100.00%</b>		

---

---

# Public Employees' Retirement Board

## *A Component Unit of the State of Montana*

### Notes to the Required Supplementary Information

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of latest actuarial valuation follows:

	PERS-DBRP	JRS	HPORS
Valuation date	June 30, 2004	June 30, 2004	June 30, 2004
Actuarial cost method	Entry Age	Entry Age	Entry Age
Amortization method	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open
<b>Remaining amortization period in years:</b>			
Unfunded Liability	does not amortize <sup>1</sup>		19.1
Unfunded Credit <sup>2</sup>		30	
Asset valuation method	4-Year smoothed market	4-Year smoothed market	4-Year smoothed market
<b>Actuarial assumptions:</b>			
Investment rate of return compounded annually	8%	8%	8%
<b>Projected salary increases</b>			
General Wage Growth	4.25%	4.25%	4.25%
Merit	0% - 6%	None	0% - 7.3%
<b>Benefit Adjustments</b>			
GABA	3% after 1 yr	3% after 1 yr	3% after 1 yr
Non-GABA	N/A	Annual increase to salary of active member in like position	2% per yr service for newly confirmed officer

<sup>1</sup> The unfunded actuarial liability will not amortize over the next 30 years. Based on actuarial assumptions as of June 30, 2004, additional funding is required at a rate of 1.19% for PERS, 2.15% for SRS and 0.23% for GWPORS. The PERB will be requesting to increase the employer contribution rates during the next Legislative Session.

<sup>2</sup> Assets are larger than the past service liability - creating an unfunded credit; the credit is amortized over future costs.

---

SRS	GWPORS	MPORS	FURS	VFCA
June 30, 2004 Entry Age	June 30, 2004 Entry Age	June 30, 2004 Entry Age	June 30, 2004 Entry Age	June 30, 2004 Entry Age
Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of revenue, open
does not amortize <sup>1</sup>	does not amortize <sup>1</sup>	24.4	18.7	20
4-Year smoothed market	4-Year smoothed market	4-Year smoothed market	4-Year smoothed market	4-Year smoothed market
8%	8%	8%	8%	8%
4.25% 0% - 7.3%	4.25% 0% - 7.3%	4.25% 0% - 7.3%	4.25% 0% - 7.3%	N/A N/A
3% after 1 yr N/A	3% after 1 yr N/A	3% after 1 yr 50% newly confirmed officer	3% after 1 yr 50% newly confirmed officer	N/A N/A

---

---

This page intentionally left blank

# Public Employees' Retirement Board

*A Component Unit of the State of Montana*

## Supporting Schedule

### Schedule of Administrative Expenses

**Year Ended June 30, 2004**

	Defined Benefit Plans	PERS-DBRP Education Fund	Defined Contribution PERS-DCRP	Deferred Compensation 457 Plan
<b>Personal Services</b>				
Salaries	\$ 1,075,547	\$ 56,228	\$ 93,827	\$ 90,010
Board Members' Per Diem	6,405		224	222
Employee Benefits	314,017	15,060	26,679	24,130
<b>Total Personal Services</b>	<b>1,395,969</b>	<b>71,288</b>	<b>120,730</b>	<b>114,362</b>
<b>Other Services</b>				
Consulting Services	171,521	3	29,887	16,275
Legal Fees and Court Costs	18,790		63	63
Payroll Fees	814	59	69	53
Audit Fees	40,525		1,293	1,293
Medical Services	18,461			
Microfilming				
Records Storage	8,902	29	29	22
Pre-Retirement Seminars		2,000		
Computer Processing	239,780	4,194	5,887	2,078
Printing and Photocopy Charges	45,959	10,936	755	1,658
Warrant Writing Services	33,751		1,077	1,077
Other	15,426	1,250	4,481	4,178
<b>Total Other Services</b>	<b>593,929</b>	<b>18,471</b>	<b>43,541</b>	<b>26,697</b>
<b>Communications</b>				
Recruitment Costs	6		98	
Postage and Mailing	106,618	17,609	1,667	4,434
Telephone	27,290	1,462	2,072	1,637
<b>Total Communications</b>	<b>133,914</b>	<b>19,071</b>	<b>3,837</b>	<b>6,071</b>
<b>Other Expenses</b>				
Supplies and Materials	39,028	1,757	1,996	1,183
Travel	26,224	5,413	5,099	5,338
Rent	172,355	12,393	14,625	11,232
Repairs and Maintenance	1,953	106	162	125
Depreciation/Amortization	594,995		6,006	3,341
Compensated Absences	11,557	(5,012)	(26,631)	(2,021)
Interest Payments			40,703	
Miscellaneous	35,129	2,414	3,930	3,345
<b>Total Other Expenses</b>	<b>881,241</b>	<b>17,071</b>	<b>45,890</b>	<b>22,543</b>
<b>Total Administrative Expenses</b>	<b>\$ 3,005,053</b>	<b>\$ 125,901</b>	<b>\$ 213,998</b>	<b>\$ 169,673</b>

---

# Public Employees' Retirement Board

*A Component Unit of the State of Montana*

## **Supporting Schedule**

### **Schedule of Investment Expenses**

***Year Ended June 30, 2004***

<u>Plan</u>	<u>Investment Manager</u>	<u>Fees</u>
PERS-DBRP	Board of Investments	\$ 3,761,001
JRS	Board of Investments	51,440
HPORS	Board of Investments	91,148
SRS	Board of Investments	160,968
GWORS	Board of Investments	50,623
MPORS	Board of Investments	163,075
FURS	Board of Investments	155,476
VFCA	Board of Investments	21,976
457	PIMCO	405,879
	State Street Bank	<u>45,319</u>
<b><i>Total Investment Expense</i></b>		<b><u><u>\$ 4,906,905</u></u></b>

---

## Public Employees' Retirement Board

*A Component Unit of the State of Montana*

### **Supporting Schedule**

### **Schedule of Consultants**

***Year Ended June 30, 2004***

<b>Individual or Firm</b>	<b>Nature of Service</b>	<b>Amount Paid</b>
Wisetek	Web Reporting Systems Development	\$ 211,356
Computer Consulting Corporation	Computer Programming Services	123,284
Legislative Audit Division, Legislative Branch	Independent Auditors	43,111
Americh Massena & Associates, Inc.	Mutual Funds Performance Review	30,250
Legal Services Division, Department of Justice	Legal Services	12,409
Milliman	Actuarial Consultant	10,438
Lawrence R. McEvoy, MD	Medical Consultant	8,040
Goetz, Gallik, Baldwin & Dolan	Legal Services	4,412
Professional Development Center, Department of Administration	Retirement Planning Seminars	2,000



# Public Employees' Retirement Board

*A Component Unit of the State of Montana*

**Detail of Fiduciary Net Assets (PERS-DBRP and PERS-DBEd)**  
**as of June 30, 2004**

	PERS-DBRP	PERS-DBEd	TOTAL
<b>Assets</b>			
Cash and Short-term Investments	\$ 103,036,190	\$ 686,424	\$ 103,722,614
Securities Lending Collateral	141,310,880		141,310,880
Receivables			
Interest	10,400,288		10,400,288
Accounts Receivable	1,431,540	9	1,431,549
Due from Other Funds	274,218	13,419	287,637
Due from Primary Government	73,854	79	73,933
Advances to Other Funds		85,500	85,500
Notes Receivable	326,441		326,441
<b>Total Receivables</b>	<b>12,506,341</b>	<b>99,007</b>	<b>12,605,348</b>
Investments, at fair value			
Montana Domestic Equity Pool (MDEP)	1,469,962,550		1,469,962,550
Retirement Fund Bond Pool (RF8P)	805,839,505		805,839,505
Montana International Pool (MTIP)	434,916,502		434,916,502
Montana Private Equity Pool (MPEP)	128,797,001		128,797,001
Equity Index Fund	23		23
Real Estate Investments	8,409,210		8,409,210
Mortgages & Commercial Loans			
net of Accumulated Mortgage Discount	66,755,267		66,755,267
<b>Total Investments</b>	<b>2,914,680,058</b>		<b>2,914,680,058</b>
Capital Assets			
Property and Equipment, at cost,			
net of Accumulated Depreciation	1,436		1,436
Intangible Assets, at cost,			
net of Amortization Expense	535,229		535,229
<b>Total Capital Assets</b>	<b>536,665</b>		<b>536,665</b>
<b>Total Assets</b>	<b>3,172,070,134</b>	<b>785,431</b>	<b>3,172,855,565</b>
<b>Liabilities</b>			
Securities Lending Collateral Liability	141,310,880		141,310,880
Accounts Payable	434,860	3,918	438,778
Due to Other Funds	72,790		72,790
Due to Primary Government	53,383	3,196	56,579
Deferred Revenue	51,408		51,408
Compensated Absences	237,203	9,114	246,317
<b>Total Liabilities</b>	<b>142,160,524</b>	<b>16,228</b>	<b>142,176,752</b>
<b>Net Assets Held in Trust for Pension Benefits*</b>	<b>\$ 3,029,909,610</b>	<b>\$ 769,203</b>	<b>\$ 3,030,678,813</b>

# Public Employees' Retirement Board

*A Component Unit of the State of Montana*

**Detail of Changes in Fiduciary Net Assets (PERS-DBRP and PERS-DBEd)  
for the Fiscal Year Ended June 30, 2004**

	PER5-DBRP	PER5-DBEd	TOTAL
<b>Additions</b>			
<b>Contributions</b>			
Employer	\$ 57,452,903	\$ 349,420	\$ 57,802,323
Plan Member	61,910,738		61,910,738
Membership Fees	130		130
Interest Reserve Buyback	753,647		753,647
Retirement Incentive Program	427,579		427,579
Miscellaneous Revenue	1,182	70	1,252
State Contributions	402,566		402,566
<i>Total Contributions</i>	120,948,745	349,490	121,298,235
<b>Investment Income</b>			
Net Appreciation (Depreciation) in Fair Value of Investments	203,084,283		203,084,283
Interest	143,492,701	7,264	143,499,965
Dividends	17,166,404		17,166,404
Investment Expense	(3,761,001)		(3,761,001)
<i>Net Investment Income</i>	359,982,387	7,264	359,989,651
<b>Securities Lending Income</b>			
Securities Lending Income	1,487,479		1,487,479
Securities Lending Rebate and Fees	(1,211,320)		(1,211,320)
<i>Net Securities Lending Income</i>	276,159		276,159
<b>Total Net Investment Income</b>	360,258,546	7,264	360,265,810
<b>Total Additions</b>	481,207,291	356,754	481,564,045
<b>Deductions</b>			
Benefits	132,683,144		132,683,144
Refunds to Members	10,913,131		10,913,131
Refunds to Other Plans	398,049		398,049
Transfers to DCRP	1,295,269		1,295,269
Transfers to ORP	188,331		188,331
Administrative Expenses	2,699,304	125,901	2,825,205
<b>Total Deductions</b>	148,177,228	125,901	148,303,129
<b>Net Increase (Decrease)</b>	333,030,063	230,853	333,260,916
<b>Net Assets Held in Trust for Pension Benefits</b>			
Beginning of Year	2,695,823,965	538,350	2,696,362,315
Prior Period Adjustment	1,055,582		1,055,582
End of Year	\$ 3,029,909,610	\$ 769,203	\$ 3,030,678,813

## Public Employees' Retirement Board

*A Component Unit of the State of Montana*

### **Detail of Fiduciary Net Assets (PERS-DCRP, PERS-DCEd and PERS-DC Disability)** **as of June 30, 2004**

	PERS-DCRP	PERS-DCEd	PERS-DC DISABILITY	TOTAL
<b>Assets</b>				
Cash and Short-term Investments	\$ 141,705	\$ 30,923	\$ 164,372	\$ 337,000
Receivables				
Accounts Receivable	11	91		102
Due from Other Funds	26,932	107	702	27,741
<b>Total Receivables</b>	26,943	198	702	27,843
Investments, at fair value				
Defined Contributions Fixed Investments	914,437			914,437
Defined Contributions Variable Investments	19,565,685			19,565,685
<b>Total Investments</b>	20,480,122			20,480,122
Intangible Assets, at cost, net of Amortization Expense	5,756			5,756
<b>Total Assets</b>	20,654,526	31,121	165,074	20,850,721
<b>Liabilities</b>				
Accounts Payable	4,612			4,612
Due to Other Funds	13,802	13,420		27,222
Due to Primary Government	25,210			25,210
Advances from Primary Government	1,390,195			1,390,195
Advances from Other Funds	85,500			85,500
Compensated Absences	19,937			19,937
<b>Total Liabilities</b>	1,539,256	13,420		1,552,676
<b>Net Assets Held in Trust for Pension Benefits</b>	<b>\$ 19,115,270</b>	<b>\$ 17,701</b>	<b>\$ 165,074</b>	<b>\$ 19,298,045</b>

## Public Employees' Retirement Board

*A Component Unit of the State of Montana*

### **Detail of Changes in Fiduciary Net Assets (PERS-DCRP, PERS-DCEd and PERS-DC Disability)** **for the Fiscal Year Ended June 30, 2004**

	PERS-DCRP	PERS-DCEd	PERS-DC DISABILITY	TOTAL
<b>Additions</b>				
<b>Contributions</b>				
Employer	\$ 1,650,635	\$ 9,782	\$ 120,361	\$ 1,780,778
Plan Member	2,661,190			2,661,190
Miscellaneous Revenue	127,255			127,255
Forfeiture of Nonvested Member	135,246			135,246
<b>Total Contributions</b>	4,574,326	9,782	120,361	4,704,469
<b>Investment Income</b>				
Net Appreciation (Depreciation) in Fair Value of Investments	1,953,417			1,953,417
Interest	426,421	235	1,255	427,911
<b>Net Investment Income</b>	2,379,838	235	1,255	2,381,328
<b>Total Additions</b>	6,954,164	10,017	121,616	7,085,797
<b>Deductions</b>				
Refunds to Members	2,239,701			2,239,701
Administrative Expenses	217,205	(3,207)		213,998
Miscellaneous Expenses	214,218			214,218
<b>Total Deductions</b>	2,671,124	(3,207)		2,667,917
<b>Net Increase (Decrease)</b>	4,283,040	13,224	121,616	4,417,880
<b>Net Assets Held in Trust for Pension Benefits</b>				
Beginning of Year	14,832,483	4,477	43,458	14,880,418
Prior Period Adjustment	(253)			(253)
<b>End of Year</b>	<b>\$ 19,115,270</b>	<b>\$ 17,701</b>	<b>\$ 165,074</b>	<b>\$ 19,298,045</b>

## **Board's Response**



# PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION



JUDY MARTZ  
GOVERNOR

STATE OF MONTANA

(406) 444-3154

TELEFAX (406) 444-5428  
TOLL FREE (877) 275-7372

100 N. PARK, SUITE 200  
PO BOX 200131  
HELENA, MONTANA 59620-0131

RECEIVED

DEC 13 2004

LEGISLATIVE AUDIT DIV.

December 13, 2004

Scott A. Seacat, Legislative Auditor  
Legislative Audit Division  
State Capitol  
Helena MT 59620

Dear Mr. Seacat,

We have reviewed the recommendations pertaining to the Financial-Compliance Audit of the Public Employees' Retirement Board for the two fiscal years ended June 30, 2004:

RECOMMENDATION #1:

WE RECOMMEND THE PERB SEEK LEGISLATION FOR FUNDING CHANGES TO ENSURE THE PERS-DBRP, SRS, AND GWPORS ARE FUNDED ON AN ACTUARIALLY SOUND BASIS, AS REQUIRED BY PERB POLICY AND THE MONTANA CONSTITUTION.

Response: We concur. Public Retirement Systems are required to be actuarially sound as required by the Montana Constitution. If retirement systems are determined not to be actuarially sound, then action is required by the legislature to maintain the actuarial soundness of all public retirement systems.

The PERB worked in conjunction with the Legislative Auditor and had an Actuarial Review performed by an independent actuary on the Public Employees Retirement System's Actuarial Valuation. The audit did not find any significant errors or concerns regarding the valuation prepared by the PERB's actuary. They found the work performed by the PERB's actuary was reasonable and performed in accordance with generally accepted actuarial principles and practices.

According to the PERB's July 1, 2004 Actuarial Valuations the actuarial soundness of the PERS-DBRP, SRS, and GWPORS needs to be addressed by the legislature. Based on Valuations, Montana's Constitution and the PERB's Benefit and Funding Policy the PERB is introducing legislation that addresses this recommendation.

Page B-3

"AN EQUAL OPPORTUNITY EMPLOYER"

**RECOMMENDATION #2:**

**WE RECOMMEND THE PERB COMPLY WITH THE CONSTITUTIONAL REQUIREMENT PROHIBITING DIVERSION OF PUBLIC RETIREMENT SYSTEM ASSETS.**

**Response:** We concur. The interentity loan between the PERS–DBED and the PERS–DCRP Administrative Fund was needed in order for the State of Montana not to default on the DCRP startup loan. This INTERENTITY loan has been paid off in its entirety including interest at the STIP rate. The STIP rate is the same rate of interest the PERS-DBED receives on its money.

The following is our analysis in using the PERS-DBED for the interentity loan:

19-3-2114(2), MCA allows transfer “from the PERS -defined benefit plan to the PERS -DC plan member's retirement account”. Implicit in this statutory authority is the application of the definition of “retirement plan”.

“Retirement plan” or “plan” means either a defined benefit plan or a defined contribution plan under one of the public employee retirement systems enumerated in 19-2-302.

Section 19-2-303(38), MCA.

The public employees’ retirement system consists of the defined benefit plan and the defined contribution plan. Each plan within the system is governed by the applicable provisions of chapter 2 and this chapter.

Section 19-3-103(2), MCA.

Inherent in the structure of the DCRP is the fundamental position that transfers within the public employees’ retirement system (whether transfers from the DBRP to the DCRP accounts or to the PERS education fund or to the PERS DCRP disability fund) do not violate the constitutional proscriptions against diversion. The money is being used as allowed by the Constitution, to provide benefits or to defray administrative expenses within the system.

Montana Constitution, Article VIII, Section 15(2). Whether the allocation of employer contributions causes the money to never reach the DBRP pension trust fund or the money reaches the DBRP pension trust fund and is later transferred to another account within the PERS, the money is constitutionally permitted to be used for providing benefits or defraying administrative expenses within the public employees’ retirement system.

By this analysis, constitutionality is not an issue for the contributions, the education fund money, or the disability fund money, regardless of where they are transferred within the retirement system or when they are transferred. The only issue is whether the timing of the transfers complies with the statutes.

The start up of the PERS-DCRP was an extraordinary situation. MPERA has no intention of ever doing an interentity loan between PERS-DBED and PERS-DCRP and we concur with this recommendation.

**RECOMMENDATION #3:**

**WE RECOMMEND:**

- A. SEEK LEGISLATION, OR AN ATTORNEY GENERAL'S OPINION, TO CLARIFY THE APPROPRIATE INTERPRETATION OF STATE LAWS GOVERNING PERS-DCRP TRANSFER CALCULATION.
- B. MATCH EDUCATION FUND EXPENSES WITH EDUCATION FUND CONTRIBUTIONS TO ELIMINATE DIVERSION OF PENSION TRUST FUND ASSETS.

**Response:** We concur. The transfer from the DBRP to the DCRP is presumed valid. Section 19-3-2114(2), MCA allows transfer "from the defined benefit plan to the [DC plan] member's retirement account".

The amount to be transferred to the DC Plan member's retirement account is the amount "that would have been credited to the member's account pursuant to 19-3-2117".

For an employee hired on or after the effective date of the defined contribution plan who elects to become a member of the plan, the board shall transfer from the defined benefit plan to the member's retirement account an amount equal to **the amount that would have been credited** to the member's account pursuant to 19-3-2117 had the employee become a plan member on the employee's hire date, plus 8% compounded annual interest.

Section 19-3-2114(2), MCA. The terms of Section 19-3-2114(2), MCA clearly anticipate that both member contributions and a portion of the employer contributions (plus 8% interest) would be included in the "amount that would have been credited". That is the application given the statute by MPERA, which is not challenged by the audit question.

However, the phrase "amount that would have been credited" is significant because the literal terms of Section 19-3-2117, MCA only provide that the **member contributions** be "**credited**". The **employer contributions** are, instead, "**allocated**" to the member's account, to the DBRP, to the education fund, and to the DCRP disability fund.



- (1) Each plan member's retirement account **must be credited** with the member contributions made under 19-3-315.
- (2) Subject to adjustment by the board as provided in 19-3-2121, **beginning on the plan's effective date**, of the employer contributions under 19-3-316, an amount equal to:
  - (a) 4.19% of compensation **must be allocated** to the member's retirement account;
  - (b) 2.37% of compensation **must be allocated** to the defined benefit plan as the plan choice rate; and
  - (c) 0.04% of compensation **must be allocated** to the education fund as provided in 19-3-112(1)(b).
- (3) Subject to adjustment by the board pursuant to 19-3-2121(6) and **beginning on the plan's effective date**, of the employer contributions under 19-3-316, 0.3% of compensation **must be allocated** to the long-term disability plan trust fund established pursuant to 19-3-2141.

Section 19-3-2117, MCA (in part; bold added for emphasis):

Because the phrase "must be allocated" as used in Section 19-3-2117(2)(a), MCA is the equivalent of "must be credited" as used in Section 19-3-2117(1), MCA, when the phrase "must be allocated" is used in Section 19-3-2117(2)(c) and (3), MCA, those subsections must also be read as "must be credited".

The other significant phrase in Section 19-3-2117, MCA is "beginning on the plan's effective date". That is the only restriction on the beginning date of when the amount is credited to the education fund or the DCRP disability fund contained in the statute. If the employer contributions were not to be credited to the education fund or the DCRP disability fund until the employee transferred to the DCRP, the legislature would have included that further restriction in the statute. Because such a restriction doesn't appear in the statute, it can not be presumed.

MPERA's feels the only interpretation of Section 19-3-2117, MCA is as an allowed transfer of amounts "credited" to specified accounts of the amounts conditionally deposited in the DBRP "beginning on the plan's effective date". MPERA further agrees the structure of 19-3-2114 and 19-3-2117 could be clearer and the PERB will take the Legislative Auditor's recommendation to seek legislation to clarify these sections.

RECOMMENDATION #4:

WE RECOMMEND THE PERB IMPLEMENT PROCEDURES TO ENSURE MUTUAL AND FIXED FUND ASSET BALANCES RECORDED ON SABHRS RECONCILE TO EXTERNAL INVESTMENT REPORTS.

Response: We concur. Although we do have a quarterly reconciliation process in place, we have been carrying unreconciled differences. We inherited the 457 deferred compensation plan from the Department of Administration with unreconciled differences. We then changed vendors and later established direct trading. We also implemented the defined contribution plan. We have been communicating with the vendors to determine what information can be provided, in what format, and at what carrying value to ensure that we are properly taking into account all the parts. The process is very complicated and involves working with three different vendors: an investment manager, custodial bank and a third-party record-keeper. We have made great strides in this process and felt that the unreconciled differences were immaterial to the plans as a whole. We will work at redefining the process and improving communications with our vendors to ensure our reconciliation process with the activity of the mutual and fixed funds between PERB and the vendors is taken one step further to compare SABHRS balances to the respective vendor reports.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael O'Connor", written in a cursive style.

Michael O'Connor  
Executive Director